90-727

Supreme Court, U.S.
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No.

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1990

ROBERT G. HOLMES, JR.,
Petitioner,
VS.
SECURITIES INVESTOR PROTECTION CORPORATION, EUGENE W. BELL, Trustee for the Liquidation of Joseph Sebag Incorporated, and LAURENCE A. SCHROEDER, Successor Trustee for the Liquidation of First State Securities Corporation,
Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether a party which was neither a purchaser nor a seller of securities, and for that reason lacked standing to sue under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, is free of that limitation on standing when presenting essentially the same claims under the Racketeer Influenced and Corrupt Organizations Act ("RICO").

2. Whether liability under RICO, or under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, may be imposed against a defendant, as a co-conspirator, when his own conduct has no causal connection to the harm sustained by the plaintiff.

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ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

PETITION FOR WRIT OF CERTIORARI

OPINIONS BELOW

The Opinion and Judgment of the United States Court of Appeals for the Ninth Circuit is reported at 908 F.2d 1461 (9th Cir. 1990) and is printed in Appendix A hereto, *infra*, page 22a. The Orders for Summary Judgment of the United States District Court for the Central District of California are printed in Appendix A hereto, *infra*, pages 22a-46a. Other opinions rendered at earlier points in this case by the United States Court of Appeals for the Ninth Circuit are reported at 764 F.2d 1309 (9th Cir. 1985) and at 803 F.2d 1513 (9th Cir. 1986) and are

printed in Appendix A hereto, *infra*, pages 64a and 46a, respectively.

JURISDICTION

The judgment of the Court of Appeals for the Ninth Circuit (Appendix A, *infra*, page 1a) was entered on August 3, 1990. The jurisdiction of the Supreme Court is invoked under 28 U.S.C. § 1254(1) and Rule 10.1(a) of the Rules of the Supreme Court of the United States.

STATUTES INVOLVED

1. The Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C.A. §§ 1961-68 (West. 1984), printed in Appendix A hereto, *infra,* page 86a.

2. The Securities Exchange Act of 1934, 15 U.S.C.S. § 78j(b) (Law Co-op. 1983) and Securities and Exchange Commission Rule 10b-5, 17 CFR § 240.10b-5, printed in Appendix A hereto, *infra,* page 97a.

3. The Securities Investor Protection Act, 15 U.S.C.S. §§ 78aaa-78lll (Law. Co-op. 1983), printed in Appendix A hereto, *infra,* page 98a.

STATEMENT OF CASE

I.

Background

In 1983, the Securities Investor Protection Corporation ("SIPC") and the trustees of two failed securities brokerage firms, First State Securities Corporation ("FSSC") and Joseph Sebag, Inc. ("Sebag") brought this action against seventy-five defendants including the

petitioner, Robert G. Holmes, Jr. ("Holmes"). FSSC and Sebag had previously been placed in liquidation by SIPC in 1981 after FSSC and Sebag failed to meet statutory net capital requirements. SIPC and the trustees sued to recover losses sustained as a result of an alleged conspiracy among the defendants, including Holmes, to manipulate, through FSSC and Sebag, the prices of stocks of six publicly traded corporations. SIPC and the trustees asserted claims under the Racketeer Influenced And Corrupt Organizations Act, 18 U.S.C. §§ 1961-68 ("RICO") and the Securities Exchange Act of 1934 (the "Exchange Act"), 15 U.S.C. § 78j(b) and Rule 10b-5 promulgated thereunder.[1]

II.

The Parties To The Appeal Below

Holmes, the petitioner herein, is the founder, chief executive officer, president and a major shareholder of Aero Systems, Inc. ("Aero.") Aero is one of the six corporations whose stock SIPC alleges was manipulated. Holmes was also a major shareholder of Bunnington Corporation ("Bunnington"), another of the six corporations whose stock was allegedly manipulated.

SIPC, one of the appellants below, was established in 1970 by the Congress pursuant to the Securities Investor Protection Act, 15 U.S.C. §§ 78aaa-78111. Among other purposes, SIPC was empowered to reimburse customer claims when member securities brokerages went into liquidation due to financial failure and had insufficient assets to meet customer claims. SIPC alleges that it had

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[1]Section 10(b), 15 U.S.C. § 78j(b) and Rule 10b-5, 17 CFR § 240.10b-5., Appendix A, hereto, *infra*, pages 97a and 98a respectively.

to disburse nearly $13,000,000 to meet claims of customers of FSSC and Sebag which FSSC's and Sebag's assets were insufficient to statisfy. SIPC sued to recover those losses from Holmes and other defendants. The trustees, the other appellants below, were appointed to liquidate FSSC and Sebag and separately sued Holmes for the destruction of the business and loss of goodwill of FSSC and Sebag.

III.

The Proceedings Below

Holmes moved for summary judgment in the District Court for the Central District of California (the "District Court") on the grounds, among others, that SIPC had no standing to maintain claims against him under Section 10(b) and Rule 10b-5 of the Exchange Act because SIPC was not a purchaser or seller of securities. Holmes also asserted that he was not liable to either SIPC or to the trustees because his acts, taken alone or in conjunction with those of others, were not the proximate cause of the financial failure of the brokerages. Holmes also argued that SIPC and the trustees had no standing under RICO to sue him for the failure of the brokerages because SIPC's and the trustees' damages were not caused "by reason of" the alleged RICO violations. Furthermore, SIPC did not have standing to assert RICO claims against Holmes which were predicated upon Holmes' alleged predicate offenses under Section 10(b) of the Exchange Act and Rule 10b-5 thereunder because SIPC, not having been a purchaser or seller of the securities, had no standing to assert the alleged predicate claims.

In the courts below, SIPC and the trustees argued that Holmes, acting in concert with others, caused the demise of FSSC and Sebag by artificially inflating the price of

Aero's stock through the issuance of false and misleading press releases. The plaintiffs argued that the alleged inflated price of Aero stock enabled the brokerages to acquire massive inventories of other allegedly manipulated stock. The plaintiffs argued that these excess inventories were the reason for FSSC's and Sebag's failure because the price of the stocks dropped when the alleged manipulation was discovered.

SIPC and the trustees also alleged that Holmes assisted other defendants to manipulate the price of Bunnington stock by controlling the supply of the stock while helping to create the illusion of an active market in the stock. They further alleged that Holmes assisted the principals of FSSC to hide FSSC's poor financial condition from regulatory authorities by allowing FSSC to "park" shares of Bunnington stock in Holmes' trading account.

Holmes denied inflating the price of Aero's stock artificially and argued that even if he did, that manipulation was not the cause of the failure of the brokerages. The failure of the brokerages was caused by wrongdoing of Joseph Lugo, a principal and brokerage officer of FSSC and Rodger Garrity, a former brokerage officer of Sebag, who manipulated securities between themselves and engaged in other wrongdoing, none of which involved Holmes. Holmes contended that there was no evidence that Holmes' trading in Bunnington stock was in assistance of the alleged manipulation of Bunnington stock by others. Holmes also produced evidence to show that conduct which plaintiffs alleged constituted "parking" of Bunnington shares was lawful and proper and there was no "parking" of securities.

A. The District Court's Rulings

In ruling on Holmes' motions for summary judgment, the District Court concluded that Holmes' conduct was not sufficiently connected to SIPC's and the trustees' losses to have been a proximate cause of those losses. The District Court further concluded that although there were genuine issues of fact as to whether Holmes conspired to violate RICO, there was no genuine dispute that SIPC was not a purchaser or seller of securities and that SIPC therefore had no standing to assert RICO claims predicated upon violation of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. Furthermore, the District Court concluded that Holmes was entitled to summary judgment with respect to both the Exchange Act claims and the RICO claims because Holmes' conduct was not causally connected to SIPC's and the trustees' losses. The District Court therefore granted summary judgment to Holmes on both the Rule 10b-5 and the RICO claims for the same reason, that is, the lack of a causal nexus between Holmes' conduct and the plaintiffs' losses.

The District Court noted, in its conclusions of law, that the grant of summary judgment to Holmes with respect to both the Exchange Act and RICO claims was because the "proximate cause" requirement under RICO was no different than the "loss causation" requirement under the securities laws. In essence, therefore, the District Court concluded that Holmes' conduct (i.e. the very overt acts claimed by SIPC and the trustees to have aided the conspiracy) was not causally connected to the claimed losses.

B. The Ninth Circuit's Reversal

The Court of Appeals for the Ninth Circuit reversed the District Court and stated that even though Holmes' own

conduct was not causally connected to the harm alleged, if Holmes was a conspirator then he was legally responsible for SIPC's and the trustees' losses, as long as Holmes' co-conspirators caused SIPC's and the trustees' losses. The Ninth Circuit also held that SIPC need not have been a purchaser or seller of securities in order to acquire standing to assert RICO claims predicated upon Holmes' alleged Section 10(b) and Rule 10b-5 violations.

BASIS FOR FEDERAL JURISDICTION IN THE DISTRICT COURT FOR THE CENTRAL DISTRICT OF CALIFORNIA

Respondents SIPC and the trustees invoked Federal jurisdiction in the United States District Court for the Central District of California on the basis of 28 U.S.C. § 1331; 18 U.S.C. § 1961 *et. seq.*; and 15 U.S.C. §§ 78a *et. seq.*

REASONS FOR GRANTING WRIT

I.

The Decision Of The United States Court Of Appeals For The Ninth Circuit, Giving A Plaintiff Who Is Not A Purchaser Or Seller Of Securities Standing To Sue Under RICO, Based Upon Alleged Violations Of Section 10(b) Of The Exchange Act And Rule 10b-5 Thereunder, Is In Conflict With Opinions Of The Fourth And Eighth Circuits And Certiorari Should Therefore Be Granted To Resolve The Conflict Among The Circuits In This Important Area Of Federal Securities Fraud Law

The Ninth Circuit has decided, in this action, that there is no requirement under RICO for a plaintiff to be a purchaser or seller of securities in order to have standing

to assert a RICO claim on the basis of predicate acts violative of Section 10(b) and Rule 10b-5 of the Exchange Act. This position conflicts with those of the Fourth and Eighth Circuits which positions have been adopted by the district courts of several other circuits, including the District Court below.[2]

The judgment and opinion of the Ninth Circuit also undermines the well-developed "standing" limitations which have been nurtured over forty years of federal securities law. These "standing" limitations exclude remote parties to a securities transaction, such as SIPC in the instant case, from recovering damages in a private action against one of the parties to the securities transaction.

In the instant case, plaintiff SIPC was not a purchaser or seller of any securities and failed to show, in the District Court, that it was subrogated to the claims of any of FSSC's or Sebag's customers who had unauthorized transactions in their accounts and who were themselves purchaser or sellers of securities.[3] SIPC, in effect, was a

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[2]*See International Data Bank, Ltd. v. Zepkin*, 812 F.2d 149 (4th Cir. 1987); *Brannan v. Eisenstein*, 804 F.2d 1041, 1046 (8th Cir. 1986); *Chief Consol. Mining Co. v. Sunshine Min. Co.*, 725 F.Supp 1191, 1194 (D. Utah 1989); *Data Controls North, Inc. v. Financial Corporation of America*, 688 F.Supp. 1047, 1052 (D. Md. 1988) (in dicta, the court suggested that on the basis of *International Data Bank, Ltd. v. Zepkin*, 812 F.2d 149 (4th Cir. 1987) plaintiffs who had no legally cognizable action for securities fraud under the Exchange Act would have no standing to present their claims under RICO).

[3]SIPC was required to make such a showing in order to acquire standing under the Exchange Act, pursuant to an earlier opinion in this case by the United States Court of Appeals for the Ninth Circuit, *SIPC v. Vigman*, 803 F.2d 1513 (9th Cir. 1986), Appendix A hereto, *infra*, page 46a.

stranger to the securities transactions of which it complained.

SIPC was required, under the Securities Investor Protection Act, 15 U.S.C.S. §§ 78aaa-78lll, to reimburse customers of the failed brokerages if the brokerages' assets were insufficient to meet customer claims against the brokerages. SIPC's statutory duties, however, in no way grant to SIPC automatic standing to assert claims which SIPC is otherwise disabled from asserting by virtue of not being a direct victim of the alleged securities fraud.

The Ninth Circuit has concluded, however, that a plaintiff, such as SIPC, suing under RICO and predicating the RICO suit upon alleged offenses involving fraud in the sale of securities, need not himself be a purchaser or seller of securities. Here, SIPC predicated its RICO claims against Holmes on Holmes' alleged violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. The Ninth Circuit's decision will enable plaintiffs who are without standing to assert claims based upon securities fraud to circumvent the standing limitations imposed by the purchaser-seller rule by the simple expedient of merely re-casting and pleading such claims as RICO claims. Under the Ninth Circuit's opinion, for which review is here sought, plaintiffs who could not have sued under Section 10(b) and Rule 10b-5 may now recover treble damages under RICO for the same conduct.

The Ninth Circuit is aligned in its view of the law with the Eleventh Circuit. The Ninth and Eleventh Circuits' rationale of their decisions is that RICO has no express purchaser-seller "standing" requirement similar to that

necessary to assert claims under Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.[4]

The Eighth and Fourth Circuits have held contrary to the Ninth and Eleventh Circuits.[5] The Fourth Circuit's decision in *International Data Bank, Ltd. v. Zepkin,*[6] supports Holmes' contention that if a plaintiff predicates his RICO claims on Rule 10b-5 offenses, then the plaintiff must be a purchaser or seller of securities in order to have standing to pursue such RICO claims. In *Zepkin,* the Fourth Circuit held that a RICO plaintiff who had neither purchased nor sold securities had no standing to sue under RICO where the RICO claims were predicated upon fraud in the sale of securities.[7]

In an earlier appeal in the instant case, the Ninth Circuit held that SIPC had standing to assert Section 10(b) and Rule 10b-5 claims in this case only if SIPC could show that it was subrogated to the claims of customers of FSSC and Sebag who were victims of unauthorized transactions in their accounts.[8] In the District Court, SIPC was unable to adduce any evidence of such

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[4]*SIPC v. Holmes,* 908 F.2d 1461, 1470 (9th Cir. 1990), Appendix A, hereto, *infra,* page 1a; *Warner v. Alexander Grant & Co.,* 828 F.2d 1528, 1530 (11th Cir. 1987).

[5]*See International Data Bank, Ltd. v. Zepkin,* 812 F.2d 149 (4th Cir. 1987); *Brannan v. Eisenstein,* 804 F.2d 1041, 1046 (8th Cir. 1986).

[6]812 F.2d 149 (4th Cir. 1987).

[7]*Id.* at 155.

[8]*SIPC v. Vigman,* 803 F.2d 1513 (9th Cir. 1986), Appendix A, hereto, *infra,* page 46a.

unauthorized transactions and was therefore unable to establish that it was a purchaser or seller of securities.[9]

In holding that RICO does not require a plaintiff to be a purchaser or seller of securities in order to have standing to sue under RICO based upon predicate acts of Rule 10b-5 violations, the Ninth Circuit stated that to sue, the plaintiff need only be one "who is injured 'by reason of' fraud in the sale of securities . . . ."[10] However, this rule of standing under RICO,[11] to which the Ninth Circuit adverted, requires the plaintiff to be a proximate victim of the fraud of which he complains.[12] The "standing" limitation imposed upon non-purchasers and non-sellers of securities under Rule 10b-5 is simply a judicial recognition that such plaintiffs are not directly or proximately

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[9]*See* District Court's Conclusions of Law No's. 1 through 6 contained in the Statement of Uncontroverted Facts In Support of Motion For Summary Judgment That SIPC Lacks Standing To Assert Claims Under 1934 Securities Exchange Act, Section 10(b) and Rule 10b-5, Appendix A, hereto, *infra,* pages 22a-28a.

[10]*SIPC v. Holmes,* 908 F.2d 1461, 1466 (9th Cir. 1990), Appendix A, hereto, *infra,* page 1a.

[11]In *Sedima, S.P.R.L. v. Imrex Co.,* 473 U.S. 479, 105 S.Ct. 3275, 87 L.Ed 2d. 346 (1985) this Court held that a plaintiff seeking to sue under RICO had standing only if he was injured "by reason of" the RICO violation.

[12]*See Id.* at 496-97 (" 'a defendant who violates [RICO] Section 1962 is not liable for treble damages to everyone he might have injured by other conduct, nor is the defendant liable to those who have not been injured.' ") (citing *Haroco, Inc. v. American National Bank & Trust Co. of Chicago,* 747 F.2d 384, 398 (1984), aff'd 473 U.S. 606, 105 S.Ct. 3291, 87 L.Ed. 2d 437 (1984).

injured by the conduct of which they complain.[13] SIPC is such a plaintiff here.

The Ninth Circuit also reasoned, in its decision below, that the purchaser-seller requirement under Rule 10b-5 is a judicially created limitation which was created because the Section 10(b) right of action is implied rather than expressly provided.[14] On the other hand, because the private civil action under RICO is expressly provided, the right to sue under RICO should not be circumscribed by the courts because RICO is to be read broadly "to effectuate its remedial purposes."[15]

The Ninth Circuit's decision, however, disregards what the Fourth Circuit recognized in *International Data Bank v. Zepkin,*[16] that is, the fact that the rule of "standing" under RICO is not one that has been clearly legislated and that imposing "traditional standing requirements for securities fraud" on the plaintiff does not run afoul of this Court's holding in *Sedima.* A non-purchaser or non-seller of securities, such as SIPC here, has at most only indirect injury from the alleged fraud. The proper party to assert the action is the person more proximately situated, that is, the purchaser or seller of the securities.[17]

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[13]*See International Data Bank v. Zepkin,* 812 F.2d 149, 152 (4th Cir. 1987).

[14]*SIPC v. Holmes,* 908 F.2d 1461, 1466 (9th Cir. 1990), Appendix A hereto, *infra,* page 1a.

[15]*Id.* (Citing this Court's opinion in *Sedima, S.P.R.L. v. Imrex Co.,* 473 U.S. 479, 105 S.Ct. 3275, 87 L.Ed.2d 346 (1985)).

[16]812 F.2d 149, 153-54 (4th Cir. 1987).

[17]In the instant case, in fact, plaintiffs who claimed to have been directly injured by the alleged stock manipulations filed a class action against the defendants which was consolidated with the instant case and subsequently settled. The language of this Court in *Sedima, S.P.R.L.* v. *Imrex Co.,* 473 U.S. 479, 496, 105 S.Ct. 3275, 87 L.Ed.2d 346 (1985) suggests the need for a *casual* connection between the injury and the conduct of the defendants ("... the plaintiff only has standing if, and can only recover to the extent that, he has been injured in his business or property by the conduct constituting the violation.")

The Ninth Circuit, like the Eleventh Circuit, has stated that the RICO statute facially has no requirement analogous to the 'purchase or sale' requirement of the federal securities laws.[18] Holmes respectfully submits, however, that the view of the Fourth Circuit in *International Data Corp. v. Zepkin,*[19] is the better reasoned view, safeguards defendants from unbridled liability from remote plaintiffs, and should therefore prevail.

In *Zepkin,* the Fourth Circuit held that since the plaintiff was neither a purchaser nor a seller of securities, it had no standing under RICO to pursue a claim predicated on a Rule 10b-5 offense. The Fourth Circuit based its conclusion on the rationale of *Blue Chip Stamps v. Manor Drugstores:*[20] "[P]arties who are affected by a securities fraud only indirectly cannot sue under Rule 10b-5."[21] The Fourth Circuit in *Zepkin* concluded that Congress intended to make "the actual sale transaction" pivotal for RICO standing.[22] The Fourth Circuit also reasoned that RICO was enacted against a backdrop of forty years of federal securities laws, and that had Congress intended "the drastic result of overturning this consensus, it surely

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[18]*SIPC v. Holmes,* 908 F.2d 1461, 1466 (9th Cir. 1990), Appendix A hereto, *infra,* page 1a; *Warner v. Alexander Grant & Co.,* 828 F.2d 1528, 1530 (11th Cir. 1987).

[19]812 F.2d 149 (4th Cir. 1987).

[20]421 U.S. 723, 95 S.Ct. 1917, 44 L.Ed.2d 539 (1975).

[21]812 F.2d at 152.

[22]*Id.*

would have done so in a more explicit way."[23] The Fourth Circuit noted that although the right of action under Section 10(b) of the Exchange Act is judicially implied and the right of action under RICO is express, "many elements of the RICO action, including that of standing, have not been clearly legislated."[24] The Fourth Circuit therefore concluded that the Rule 10b-5 purchaser-seller requirement is incorporated in RICO standing where the plaintiff predicates the RICO claim on "fraud in the sale of securities"[25] Holmes respectfully urges that the Court adopt the view of the Fourth Circuit.

Holmes respectfully submits that this Court should review the Ninth Circuit's judgment below because the rule it enunciates portends of grave consequences to legitimate businesses. The onslaught of civil RICO litigation against legitimate business concerns needs no reiteration. The opinion of the court below frees plaintiffs from the restriction imposed by the purchaser-seller requirement. Thus, the opinion is bound to foster litigation among plaintiffs previously disabled from suing for alleged securities fraud under the Exchange Act. Furthermore, the Ninth Circuit's opinion below threatens to make the purchaser-seller limitation altogether obsolete. To the extent that a plaintiff can allege a "pattern" of the claimed acts of securities law violations, the plaintiff may sue under RICO where he might have been unable to sue under the Exchange Act.

The instant case provides a perfect example of the specter of the type of litigation which businesses will face in light of the Ninth Circuit's opinion. Here, for instance,

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[23] *Id.* at 152.

[24] *Id.* at 153.

[25] *Id.* at 152, 155.

SIPC would have been unable to recover its claimed $13,000,000 loss from Holmes under the Exchange Act because SIPC was not a purchaser or seller of securities. The effect of the Ninth Circuit's opinion, however, is to allow SIPC to recover treble its claimed losses ($39,000,000 rather than $13,000,000) under RICO. Even were such damages insurable, the cost to society would be high. The financial ruin of legitimate businesses is not an unlikely result as the allure of treble damages almost certainly will increase litigation in this area.

Moreover, adequate protection for legitimate business concerns should not be assumed to exist simply because of a vigilant judicial and jury system. The complexity of issues such as causation, and the very breadth of the RICO statute, may ensnare business enterprises into liability that is punitive beyond the culpability of such enterprises. Furthermore, vexatious litigation, which the purchaser-seller requirement was designed to address, is bound to increase as plaintiffs utilize the threat of RICO treble damages to wrest settlements from business concerns. The coercion of settlements in securities fraud actions is a danger which was specifically recognized by this Court in *Blue Chip Stamps v. Manor Drugstores.*[26] For these reasons, this Court should grant certiorari to review the opinion of the Ninth Circuit on the purchaser-seller issue under RICO.

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[26] 421 U.S. 723, 95 S.Ct. 1917, 44 L.Ed 2d 539 (1975).

II.

The Decision Below By The United States Court Of Appeals For The Ninth Circuit Raises A Significant Question Of Federal Law That Should Be Settled By This Court, That Is, Whether One Who Is Alleged To Be A Conspirator Under RICO Or The Securities Laws May Be Held Liable Even Though His Conduct Has No Causal Connection To The Plaintiff's Injury.

In ruling on Holmes' motions for summary judgment, the District Court concluded that Holmes' conduct was not sufficiently causally connected to the plaintiffs' losses to be a proximate cause of the losses and granted Holmes' motions for summary judgment.

The Ninth Circuit reversed on the basis that *if* Holmes conspired with co-defendants, and *if* the co-defendants caused the alleged injuries, then Holmes is legally responsible even if he did not participate in every detail of the conspiracy.[27] In point of fact, however, the District Court did not find that there was an issue for trial of whether Holmes participated in the conspiracy that caused the loss of the brokerages. The District Court found that there was a genuine issue as to whether Holmes participated in a conspiracy to violate RICO, without making a finding about the presence or absence of any causal connection between this RICO conspiracy and the harm of which plaintiffs' complained.[28]

The District Court also concluded that Holmes' conduct was not the proximate cause of the brokerages'

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[27]*SIPC v. Holmes*, 908 F.2d 1461, 1468-69 (9th Cir. 1990), Appendix A hereto, *infra*, page 1a.

[28]Finding No. 5 in District Court's Order Granting Summary Judgment (RICO Claims), Appendix A hereto, *infra*, page 45a.

failure and that any manipulation by Holmes of Aero stock had no impact on the brokerage firms' net capital deficiencies. The District Court found that "there is no evidence that Holmes knowingly, willfully or intentionally" participated in a "scheme" to manipulate Bunnington stock.[29] Presumably, though the District Court did not expressly address the matter, the RICO conspiracy in which Holmes may have participated involved Aero securities (which related to the companion class action commenced by Aero shareholders) and which did not involve the unrelated losses sustained by the brokerages as a result of manipulation of securities other than Aero by former brokerage firm officers (Lugo and Garrity). In granting summary judgment in favor of Holmes on the RICO claims, the District Court stated, "the grant of summary judgment on 'causation' applies also to the RICO claims."[30]

On the state of the record, there was no finding of a genuine dispute concerning whether Holmes was a conspirator in any conspiracy that caused the brokerage firms' losses. Holmes was found by the Ninth Circuit to be legally responsible only *if* he conspired with co-defendants, and *if* the co-defendants caused the injuries to the brokerage firms. Conspicuous by its absence is any find-

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[29]District Court's Conclusions of Law Nos. 1, 2, 6, 8 and Uncontroverted Fact Statement No. 32 contained in Statement of Uncontroverted Facts and Conclusions of Law (Causation), Appendix A, hereto, *infra*, page 31a.

[30]Finding No. 9 (asterisked notation) in District Court's Order Granting Summary Judgment (RICO Claims), Appendix A, hereto, *infra*, page 46a; Although arguably ambiguous, Finding No. 8 in the Order Granting Summary Judgment (RICO Claims), should be read in this context to mean that there is no finding of a genuine issue concerning whether the RICO conspiracy in which Holmes may have participated caused the injuries to the brokerages.

ing by the District Court or ruling by the Ninth Circuit that there is a genuine issue of fact whether Holmes was a co-conspirator in the conspiracy that caused the brokerage firms' loss.

As matters now stand, Holmes may be subjected to liability as a co-conspirator in the absence of any finding that he engaged in any act sufficiently causally connected to the ultimate harm to render it just that Holmes be treated as a co-conspirator.[31] This Court should issue a writ of certiorari to review the Ninth Circuit's decision because the decision raises a question of substantial importance in federal RICO and securities fraud law, that is, whether a party may be subjected to liability as a co-conspirator when he engaged in no conduct that is causally related to the alleged injury.

It is clear that if Holmes had participated in a conspiracy which caused the brokerages' ruin, he furthered that alleged conspiracy only if he engaged in conduct that *was causally* related to the unlawful end. The District Court found that Holmes' conduct was not so causally related. If a defendant, therefore, whose conduct did not cause the plaintiff's injury may be found liable under a conspiracy theory for the acts of others with whom there is no

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[31]In order for one to be found a civil "conspirator," one must engage in tortious acts which further the conspiracy. *Restatement (Second) of Torts*, § 876(a) and Comment on Clause (a) at 316. In contrast, in criminal conspiracy, it is the *agreement* which is the keystone of liability and the overt act of any of the conspirators in furtherance of the conspiracy is sufficient to bind all of the co-conspirators for liability. *See generally* LaFave and Scott, *Criminal Law*, §§ 61-62 at 453-95, 455 n.21, 470, 476-78. In the instant case, no overt act (conduct) of Holmes was found by the District Court to have been causally related to the plaintiffs' injuries.

evidence he unlawfully agreed to assist, then justice departs from the law.

The rule that a conspirator is liable for the conduct of his co-conspirators is justifiable only if the alleged conspirator engages in conduct which advances the conspiracy.[32] If the alleged conspirator's conduct was not causally related to the injury then it is compelling that the alleged conspirator was not in fact a conspirator. To hold otherwise, as did the Ninth Circuit, widens the scope of liability to a defendant beyond reason.

Although it is well established that to be liable a conspirator's own conduct need not be the cause of the plaintiff's injury if some conduct of his co-conspirators caused the injury, it appears that, as a theory of secondary liability, some sufficient causal nexus should be required between the overt act of the alleged conspirator and the plaintiff's injury.

Such a causal connection should be required as a condition to determining that a particular individual is a co-conspirator, particularly since the law is well settled that once co-conspirator status is established no further causal connection between the conduct of the co-conspirator and the ultimate loss need be established.[33]

Under aiding and abetting theory, as a comparison, liability is imposed if the alleged aider 1) knew of a primary violation of law and 2) provided substantial

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[32]*See Restatement (Second) of Torts*, § 876(a), Comment on Clause (a) at 316.

[33]*See e.g., International Longshoremen's & Warehousemen's Union v. Juneau Spruce Corp.*, 189 F.2d 177, 190 (9th Cir. 1952), aff'd 342 U.S. 237, 72 S.Ct. 235, 96 L.Ed. 275.

assistance to the primary violator.[34] "Substantial assistance" has been described as a requirement for a causal connection between the conduct of the aider and the plaintiff's injury.[35] Conspiracy liability, on the other hand, requires 1) knowledge of the objective; 2) agreement to the unlawful objective or to the use of unlawful means to achieve a lawful objective and 3) an overt act or acts by the conspirators.[36]

An aider and abettor, however, is liable only when his conduct is causally related to the plaintiff's injury.[37] The aider must supply "substantial assistance."[38] Similarly, a conspirator should be subjected to liability only if he engages in some conduct that is causally related to the plaintiff's injury.[39] The elements of aiding and abetting and conspiracy liability are almost identical. Often, in fact, the same conduct is alleged to support both theories of liability. Yet it would appear, at least by virtue of the Ninth Circuit's opinion below, that while an aider and abettor must supply "substantial assistance" to the primary wrongdoer in order to be liable, a conspirator may

[34]*See e.g. Bloor v. Carro, Spanbock, Londin, Rodman & Fass*, 754 F.2d 57 (2nd Cir. 1985); *Restatement (Second) of Torts*, § 876(b) at 315.

[35]*Bloor, supra*, at 62.

[36]*See* 16 Am. Jur. 2d, *Conspiracy* §§ 50, 51 at 268 (1979).

[37]*Bloor, supra*, at 62.

[38]*Id.*

[39]The *Restatement* uses the term "tortious" in describing the conduct which renders a person a "conspirator." *See Restatement (Second) of Torts*, § 876(a) at 315. Implicit in that usage, though not expressly stated, is that the conduct must have a causal connection with the harm done. This requirement is blurred by the Ninth Circuit's decision below.

be found liable even if his conduct was not at all causally related to the plaintiff's injury.[40] This result is an aberration since proof of "knowledge" under aiding and abetting liability, coupled with the requirement of "assistance" will almost certainly also support an allegation of conspiracy. The proof that one gave "assistance" provides the basis of his alleged "agreement" to achieve the unlawful end.

Under the Ninth Circuit's decision below, the actor's own conduct is relegated to such an insignificant status that the concept of the conspiratorial "agreement" is elevated, as if in a criminal conspiracy, without valid reason, and the element of responsibility supplied by the concept of causation is thereby eliminated.

The instant case provides apt illustration of the illogic or eradicating any requirement of causation between the alleged conspirator's conduct and the plaintiff's injury. If Holmes was a conspirator, he should be found liable only if he *acted in furtherance of the conspiracy*. If he did not so act, then he should not be regarded as a conspirator in the first place with respect to the causing of the plaintiffs' injuries since merely agreeing to injure another, without more, cannot be the basis for liablility.[41] If Holmes' conduct was not causally connected to the harm suffered by the plaintiffs, then he should not be liable for the

[40]While this result may be justifiable under criminal conspiracy theory where the agreement to achieve an unlawful objective is the keystone for liability, such a result appears to be unjustifiable under civil conspiracy where the alleged conspirator's overt act is required to be "tortious." *See Restatement (Second) of Torts*, § 876(a) at 315.

[41]"The mere common plan, design or even express agreement is not enough for liability in itself, and there must be acts of a tortious character in carrying it into execution." *Restatement (Second) of Torts*, § 876(a) and Comment on Clause (a) at 316.

conduct of others in the face of uncontroverted facts that he did not knowingly assist others in doing the very things which plaintiffs asserted were the cause of the brokerages' financial failure.[42]

The relationship between the settled doctrines of conspiracy liability and the concept of causation should be more precisely articulated by this Court. Requirements of causation and instances of liability for conspiracy abound in the law. On its face, the two concepts seem to operate independently of each other. The degree to which, and circumstances under which, requirements of causation must be established before liability for conspiracy may be imposed should be addressed by this Court. Robert Holmes is only one of many litigants whose status, liability and rights could be more fairly and clearly understood if this Court will see fit to address the question.

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[42]District Court's Conclusions of Law 1, 2 and 8 and Uncontroverted Facts Statements 22, 32, 33 and 34 contained in Statement of Uncontroverted Facts and Conclusions of Law (Causation), Appendix A, hereto, *infra*, page 31a.

CONCLUSION

For the foregoing reasons, this Court should issue a Writ of Certiorari to review the Judgment of the Court of Appeals for the Ninth Circuit.

Dated: November 1, 1990

Respectfully submitted,

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Robert G. Holmes, Jr.

Appendix

SECURITIES INVESTOR PROTECTION CORPORATION,
Plaintiff-Appellant,

v.

SEYMOUR VIGMAN, et al.,
Defendants,

and

ROBERT G. HOLMES, JR.,
Defendant-Appellee.

Eugene W. BELL, Trustee for the liquidation of Joseph Sebag Incorporated ("Bell"); Laurence A. Schroeder, Successor Trustee for the Liquidation of First State Securities Corporation ("Schroeder"),
Plaintiffs-Appellants,

v.

Seymour VIGMAN, et al., Defendants,

and

Robert G. Holmes, Jr.,
Defendant-Appellee.

Nos. 89-55094, 89-55128.

United States Court of Appeals,
Ninth Circuit.

Argued and Submitted March 6, 1990.
Decided Aug. 3, 1990.

In securities fraud action, the United States District Court for the Central District of California, A. Wallace Tashima, J., entered order dismissing 4 of 75 defendants on ground that court lacked personal jurisdiction and that venue was improper. Appeal was taken. The Court of Appeals, 764 F.2d 1309, reversed and remanded. On remand the District Court dismissed Securities Investor

Protection Corporation's (SIPC) securities fraud claims, and SIPC appealed. The Court of Appeals, 803 F.2d 1513, reversed and remanded. Thereafter the District Court granted summary judgment in favor of one defendant and appeal was taken. The Court of Appeals, David R. Thompson, Circuit Judge, held that: (1) SIPC could commence Racketeer Influenced and Corrupt Organizations Act (RICO) suit against former members of brokerage firm which had become defunct, and officers and directors of corporations whose stock had been traded by firm, without being purchaser of any stock, and (2) trial court could not hold as matter of law that there was no causal connection between one of the corporate officers and any loss sustained, while simultaneously holding that fact issue existed as to whether officer was participant in conspiracy to commit stock fraud.

Reversed and remanded.

1. Racketeer Influenced and Corrupt Organizations 57

Standing limitation that applies to § 10b-5 security action, that plaintiff be purchaser or seller of securities, does not apply to Racketeer Influenced and Corrupt Organizations Act claims based upon predicate acts that are alleged to be securities fraud under Securities Exchange Act and rule 10b-5. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); 18 U.S.C.A. §§ 1961-1968.

2. Racketeer Influenced and Corrupt Organizations 57

Securities Investor Protection Corporation (SIPC) had standing to bring Racketeer Influenced and Corrupt Organizations Act suit against former members of brokerage firm and executives of corporation whose stock was sold by firm, based upon predicate alleged violation of

securities fraud under Rule 10b-5, even though SIPC was not purchaser of any stocks in question. 18 U.S.C.A. §§ 1961-1968; Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); Securities Investor Protection Act of 1970, §§ 3(b)(1), 5, as amended, 15 U.S.C.A. §§ 78ccc(b)(1), 78eee.

3. Racketeer Influenced and Corrupt Organizations 62

While Securities Investor Protection Corporation and the trustee for defunct securities brokerage firm bringing Racketeer Influenced and Corrupt Organizations Act claims against former members of the firm and officers of corporation whose stock was traded by firm, alleging securities fraud as predicate offense, must establish causal connection between alleged fraud and losses they seek to recover, they need only satisfy requirements of proximate cause as understood in typical tort claim. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78(b); 18 U.S.C.A. §§ 1961-1968.

4. Racketeer Influenced and Corrupt Organizations 80

Trial court erred by holding that as a matter of law officer of corporation whose stock was traded by defunct securities brokerage firm had not caused losses sought to be recouped by Securities Investor Protection Corporation and firm's trustee, on grounds that supervening acts of other parties excused officer from liability as to particular alleged acts of securities fraud, and that officer was not legally responsible for acts attributable to others; court had also found that triable issues of fact existed on question whether officer had participated in conspiracy to commit stock fraud, and if he was found to be conspirator, he would be legally responsible for such injuries regardless of whether he had participated in every detail of

conspiracy. 18 U.S.C.A. §§ 1961-1968; Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b).

5. Federal Civil Procedure 2546

Trial court did not erroneously base its conclusion that genuine issues of material fact existed as to participant of corporate officer in alleged conspiracy to violate Racketeer Influenced and Corrupt Organizations Act (RICO) by committing predicate acts of securities fraud, on basis of expert testimony which included references to documents not attached to or identified in witnesses' declarations; under wide latitude on evidentiary decisions, trial court could rely upon experts' opinion testimony without being limited to statements in declarations. Fed.Rules Evid. Rules 703, 705, 28 U.S.C.A.

6. Federal Civil Procedure 2546

Trial court did not improperly base decision that material issues of fact existed as to whether corporate officer had participated in conspiracy to violate Racketeer Influenced and Corrupt Organizations Act (RICO) by basing determination on expert testimony which included opinion as to ultimate issues of fact; district court had discretion to accept such testimony. Fed.Rules Evid. Rules 702, 704, 28 U.S.C.A.

7. Federal Civil Procedure 2546

Officer of corporation sued by Securities Investor Protection Corporation (SIPC) and trustee of defunct brokerage house, in connection with Racketeer Influenced and Corrupt Organizations Act case having securities fraud predicate, was precluded from challenging under Rule 56 district court's consideration of SIPC and trustee's "statement of background and facts" on grounds

that it was full of unsupported allegations; Rule 56 only governed affidavits and challenged statement was only a guide to evidence. Fed.Rules Civ.Proc. Rule 56(e), 28 U.S.C.A.

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Appeal from the United States District Court for the Central District of California.

Before SCHROEDER, THOMPSON and TROTT, Circuit Judges.

DAVID R. THOMPSON, Circuit Judge:

The district court granted summary judgment in favor of defendant Holmes in this suit brought by the Securities Investor Protection Corporation ("the SIPC") and trustees of defunct stock brokerage firms. The SIPC and the trustees sued to recover losses allegedly sustained as a result of a conspiracy to manipulate the prices of stocks of publicly traded corporations. The district court concluded that the SIPC did not have standing to assert a claim under the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. §§ 1961-68 ("RICO"), when that claim was based on alleged securities violations under

section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder.[1] The district court also determined that the defendant Holmes' acts viewed separately from those of the other alleged coconspirators were not the proximate cause of the losses sustained. We have jurisdiction under Fed.R.Civ.P. 54(b) and 28 U.S.C. § 1291 and we reverse.

FACTS

In 1970, Congress established the SIPC pursuant to the Securities Investor Protection Act, codified as amended at 15 U.S.C. § 78aaa-78*lll*. The SIPC was created in the wake of the collapse of numerous brokerage houses. It was created to provide greater protection to customers of brokers and dealers and members of national securities exchanges.

The SIPC is a nonprofit corporation. Its membership consists of most registered brokers and dealers. 15 U.S.C. § 78ccc(a). It has the power "to sue and be sued, complain and defend, in its corporate name and through its own counsel, in any State, Federal, or other court." 15 U.S.C. § 78ccc(b)(1). The SIPC also has the power to apply for a protective decree from a court of competent jurisdiction and to seek the appointment of a trustee for the liquidation of a broker-dealer member's business when a broker-dealer member fails or is in danger of failing to meet obligations to customers. 15 U.S.C. § 78eee.

In late July 1981, the SIPC instituted liquidation proceedings against two securities brokerages, First State Securities Corp. ("FSSC") and Joseph Sebag, Inc. ("Sebag"). John L. Britton was appointed trustee for the

[1] Section 10(b), 15 U.S.C. § 78j(b) and Rule 10b-5, 17 C.F.R. § 240.10b-5.

liquidation of FSSC,[2] and Eugene W. Bell was appointed trustee for the liquidation of Sebag (collectively, "the trustees"). In the process of liquidating the brokerages, the SIPC alleges it had to disburse nearly $13 million to meet customers' claims for which the brokerages' assets were insufficient.

In July 1983, the SIPC and the trustees filed an action in federal district court against seventy-five defendants, alleging securities fraud in violation of section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder; a conspiracy under RICO; common law fraud; and breach of fiduciary duty. The SIPC and the trustees alleged in their complaint that from 1964 through July 1981 the defendants engaged in a scheme to manipulate the stock of six companies traded in the over-the-counter market,[3] and that the defendants used FSSC and Sebag as vehicles in the furtherance of this scheme. The defendants are officers and directors of the six companies and former principals and employees of FSSC and Sebag.

The SIPC and the trustees allege that the defendants misrepresented the six companies' prospects through statements by company officials, press releases, and financial statements. An illusion of active markets in the six stocks was allegedly maintained by misleading transactions in the defendants' accounts, in the brokerages' proprietary accounts, and in the accounts of unsuspecting customers. When the alleged scheme was uncovered, the prices of the stocks fell drastically. Because FSSC and

[2] Laurence A. Schroeder is currently the successor trustee for the liquidation of FSSC.

[3] The companies are Aero Systems, Inc., Aerosonics Corp., Bunnington Corp., Creditbank, Inc., Dash Industries, Inc., and Osrow Products Corp.

Sebag held large amounts of the stocks in their proprietary accounts, they incurred heavy losses, leading to the liquidation proceedings.

The present appeal is the third to reach this court in this litigation. In *Securities Investor Protection Corp. v. Vigman*, 764 F.2d 1309 (9th Cir.1985), the district court dismissed four defendants for lack of personal jurisdiction and improper venue. As to lack of personal jurisdiction, we reversed the dismissal of one defendant and remanded the dismissal of another for further consideration. *Id.* at 1316. We also remanded for further proceedings the district court's dismissal of these two defendants on the ground of improper venue. *Id.* at 1318. In *Securities Investor Protection Corp. v. Vigman*, 803 F.2d 1513, 1519-20 (9th Cir.1986), we reversed the dismissal of the SIPC's 10-b5 claims.

Robert G. Holmes, Jr., the only defendant involved in this appeal, is the founder, the chief executive officer, the president, and a major shareholder of Aero Systems, Inc. ("Aero"), one of the six companies whose stock was allegedly manipulated. Holmes also was a shareholder in Bunnington Corp. ("Bunnington"), another one of the six companies, during the period of the alleged manipulation. The SIPC and the trustees allege that Holmes participated in a conspiracy with certain other defendants to manipulate the price of Aero and Bunnington stock. They allege that Holmes issued false and misleading press releases and other public statements regarding a new product Aero was marketing to inflate artificially the price of Aero's stock. Further, they assert that Holmes helped other defendants manipulate the price of Bunnington's stock by purchasing large blocks of Bunnington stock and then selling in small lots, thus creating the appearance of an active trading market. Finally, the

plaintiffs allege that Holmes helped conceal FSSC's poor financial position by allowing FSSC to "park"[4] shares of Bunnington stock in Holmes' trading account.

Holmes moved for summary judgment, asserting that the SIPC lacked standing to assert a RICO claim because the SIPC was not a purchaser or seller of securities. Holmes also contended that any conduct he engaged in did not cause the losses which the SIPC and the trustees sustained.

The district court granted Holmes' motion for summary judgment. The district court concluded that genuine issues of material fact existed as to the elements of the RICO claim, including whether Holmes conspired to violate RICO, but it concluded that the SIPC did not meet the purchaser-seller requirement for standing to assert a RICO claim predicated upon violations of section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5.

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[4] "Parking" is a mechanism used to evade the net capital requirements of the National Association of Securities Dealers ("NASD"). When a brokerage firm files the required monthly report with the NASD regarding its net capital condition, it must discount in value any stock it holds in its own account (referred to as a "haircut"). To reach technical compliance with its net capital requirements, a brokerage firm "sells" stock from the brokerage's own account to a customer at market price. This avoids the discount for reporting purposes. Once the brokerage firm has filed its report with the NASD and met its net capital requirement, the firm "buys" the shares back from the customer, usually at the same price at which it sold the stock plus interest.

The SIPC and the trustees allege that Holmes conspired with FSSC to park shares of Bunnington in Holmes' account to allow FSSC to mask net capital deficiencies in its reports to the NASD. This allegedly allowed FSSC to continue its participation in the overall manipulation conspiracy.

The district court also concluded that a genuine issue of material fact existed as to whether Holmes' acts, upon which the RICO claim was based, were the *actual cause* of the losses to the SIPC and the trustees, but that there was no genuine issue for trial to dispute the fact that Holmes' acts were not the *proximate cause* of the losses. The district court reached its proximate cause conclusion by isolating Holmes' acts from the acts of other members of the alleged conspiracy, and by applying a "loss causation" requirement to the RICO claim.

DISCUSSION

This court reviews de novo a grant of summary judgment, viewing the evidence in the light most favorable to the party against whom it was granted. *Franklin v. Murphy,* 745 F.2d 1221, 1235 (9th Cir.1984). Summary judgment is proper if "there is no genuine issue as to any material fact and ... the moving party is entitled to a judgment as a matter of law." Fed.R. Civ.P. 56(c). Entry of summary judgment is mandated "against a party who fails to make a showing sufficient to establish the existence of an element essential to that party's case, and on which that party will bear the burden of proof at trial." *Celotex Corp. v. Catrett,* 477 U.S. 317, 322, 106 S.Ct. 2548, 2552, 91 L.Ed.2d 265 (1986).

A. *Purchaser-Seller Standing Limitation*

[1, 2] The SIPC argues that it need not have been a purchaser or seller of securities to have standing to bring a RICO claim based on predicate acts of securities fraud.[5] The SIPC urges us not to apply to its RICO claim the

[5]Holmes does not challenge the trustees' standing to bring a RICO claim. He challenges only the SIPC's standing to bring such a claim.

purchaser-seller standing limitation applicable to a Rule 10b-5 claim. *See Birnbaum v. Newport Steel Corp.,* 193 F.2d 461, 463-64 (2d Cir.), *cert. denied,* 343 U.S. 956, 72 S.Ct. 1051, 96 L.Ed. 1356 (1952).

In *Blue Chip Stamps v. Manor Drug Stores,* 421 U.S. 723, 95 S.Ct. 1917, 44 L.Ed.2d 539 (1975), a 10b-5 case, the Supreme Court adopted the *Birnbaum* rule. It held that, to bring a Rule 10b-5 private damages action, a plaintiff must be a purchaser or seller of securities. *Blue Chip Stamps,* 421 U.S. at 754-55, 95 S.Ct. at 1334-35. In a previous appeal in this litigation, we held that the SIPC has standing to assert Rule 10b-5 claims to the extent it can show FSSC and Sebag used customer assets without authorization to purchase or sell securities. *Securities Investor Protection Corp. v. Vigman,* 803 F.2d at 1519.

To determine whether the purchaser-seller standing limitation of a 10b-5 claim also applies to a RICO claim when the RICO claim is based on acts of securities fraud, we first look to RICO's text (*see United States v. Turkette,* 452 U.S. 576, 580, 101 S.Ct. 2524, 2527, 69 L.Ed.2d 246 (1981) and compare that text to Rule 10b-5.

Section 1962(a) of RICO provides:

> It shall be unlawful for any person who has received any income derived ... from a pattern of racketeering activity ... to use or invest ... any part of such income ... in acquisition of any interest in, or the establishment or operation of, any enterprise which is engaged in, or the activities of which affect, interstate or foreign commerce.

18 U.S.C. § 1962(a). "Racketeering activity" includes acts of "fraud in the sale of securities" and of mail fraud

and wire fraud. 18 U.S.C. § 1961(1). Section 1964 provides:

> Any person injured in his business or property by reason of a violation of section 1962 ... may sue therefor in any appropriate United States district court and shall recover threefold the damages he sustains....

18 U.S.C. § 1964(c).

On its face, the RICO statute has no purchaser-seller standing requirement. Any plaintiff who is injured "by reason of" fraud in the sale of securities may sue. *See Warner v. Alexander Grant & Co.*, 828 F.2d 1528, 1530 (11th Cir.1987). Thus, even though the predicate acts of a RICO claim may be based on allegations of fraud in the sale of securities, the RICO text does not require a plaintiff to be a purchaser or seller, so long as the plaintiff suffered injury "by reason of" the alleged fraud. In contrast, for conduct to be unlawful under Rule 10b-5, it must have occurred "in connection with the purchase or sale of any security." Rule 10b-5, 17 C.F.R. § 240.10b-5.

In addition to this textual difference between RICO and Rule 10b-5, the source of the civil remedy for violations of the two are different. RICO contains its own express civil action remedy. Neither section 10(b) of the Securities Exchange Act of 1934 nor Rule 10b-5 contains an express civil remedy for a securities fraud violation. That remedy has been implied by the courts. *See Blue Chip Stamps*, 421 U.S. at 730, 95 S.Ct. at 1922 (citing *Superintendent of Ins. v. Bankers Life & Cas. Co.*, 404 U.S. 6, 13 n. 9, 92 S.Ct. 165, 169 n. 9, 30 L.Ed.2d 128 (1971), and *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 150-54, 92 S.Ct. 1456, 1470-72, 31 L.Ed.2d 741 (1972)). The remedy of a private civil action under Rule 10b-5

having been court created, the Court has not been reluctant to limit the class of plaintiffs who may bring such a private action. *Blue Chip Stamps*, 421 U.S. at 749, 95 S.Ct. at 1931. And it has limited that class to purchasers or sellers of securities. *Id.* at 730-31, 95 S.Ct. at 1922-23.

With regard to the RICO statute, however, the private civil action for violation of it was not created by the courts, but by Congress in enacting the statute. The RICO statute contains no limitation that a plaintiff must be a purchaser or seller of a security, and it is not appropriate for this court to impose such a limitation. *Cf. Blue Chip Stamps*, 421 U.S. at 748-49, 95 S.Ct. at 1930-31 ("[I]f Congress had legislated the elements of a private cause of action for damages, the duty of the Judicial Branch would be to administer the law which Congress enacted; the Judiciary may not circumscribe a right which Congress has conferred because of any disagreement it might have with Congress about the wisdom of creating so expansive a liability.") And, as the Supreme Court has stated,

> RICO is to be read broadly. This is the lesson not only of Congress' self-consciously expansive language and overall approach, but also of its express admonition that RICO is to "be liberally construed to effectuate its remedial purposes."

Sedima, S.P.R.L. v. Imrex Co., 473 U.S. 479, 497-98, 105 S.Ct. 3275, 3285-86, 87 L.Ed.2d 346 (1985) (citation omitted) (quoting RICO, Pub.L. No. 91-452, § 904(a), 94 Stat. 947).

We hold that the purchaser or seller standing limitation that applies to 10b-5 actions does not apply to RICO claims based upon predicate acts that are alleged to be securities fraud under section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated there-

under. Accordingly, the SIPC has standing to assert its RICO claim. We now consider the district court's ruling on causation.

B. *Causation*

[3] The district court determined that in order for the SIPC and the trustees to succeed on their RICO claim against Holmes, they had to show that Holmes' acts were the proximate cause of the harm they suffered. In analyzing this causation question, the district court determined that proximate cause had not been established because the SIPC and the trustees had failed to show "loss causation" to connect Holmes' acts to the losses sustained.

We defined "loss causation" in the context of Rule 10b-5 in *Hatrock v. Edward D. Jones & Co.*, 750 F.2d 767, 773 (9th Cir.1984). There we said that "in an action brought under Rule 10b-5 for material omissions or misstatements, the plaintiff must prove both transaction causation, that the violations in question caused the plaintiff to engage in the transaction, and loss causation, that the misrepresentations or omissions caused the harm." *Id.* Having stated the "loss causation" requirement as it pertains to a Rule 10b-5 case, we then went on to hold in *Hatrock* that the plaintiffs did not have to establish "loss causation" because their claim was predicated upon allegations that the defendant broker churned securities in their account to generate commissions. *Id.* at 773-74. Thus, although the plaintiffs still had to prove a causal connection between the defendant's acts and their losses, the trial court had not erred in failing to instruct the jury on "loss causation." *Id.* at 774 & n. 5.

In *Hatrock,* we cited *Schlick v. Penn-Dixie Cement Corp.*, 507 F.2d 374, 380 (2d Cir.1974), *cert. denied,* 421

U.S. 976, 95 S.Ct. 1976, 44 L.Ed.2d 467 (1975), as the source of our definitions of "loss causation" and "transaction causation." *Schlick* was

> not a case where the 10b-5 claim [was] based solely upon material omissions or misstatements in the proxy materials. Were it so, concededly there would have to be a showing of both *loss causation* — that the misrepresentations or omissions caused the economic harm — and *transaction causation* — that the violations in question caused the appellant to engage in the transaction in question. The former is demonstrated rather easily by proof of some form of economic damage, here the unfair exchange ratio, which arguably would have been fairer had the basis for valuation been disclosed. Transaction causation requires substantially more. In a misrepresentation case, to show transaction causation a plaintiff must demonstrate that he relied on the misrepresentations in question when he entered into the transaction which caused him harm.

Id. (footnote omitted). The *Schlick* Court pointed out that the 10b-5 claim before it was based upon allegations "of a scheme to defraud which includes market manipulation and a merger on preferential terms, of which the proxy omissions and misrepresentations were only one aspect. Thus appellant need only show loss causation [and not transaction causation as well] with respect to his claim for relief under 10b-5." *Id.* at 381 (footnote omitted).

We turn now to the question whether the SIPC and the trustees must show "loss causation" to support their RICO claim, a claim which is based on predicate acts of securities fraud under the Securities Exchange Act of 1934 and Rule 10b-5. Given the analysis in *Hatrock* and

Schlick, it would appear that they do. But this does not mean that "loss causation" is some additional requirement which must be shown over and above "proximate cause." Rather, "loss causation" is simply a label used to describe the standard rule of tort law that a plaintiff must allege and prove a sufficient causal connection between the defendant's wrongdoing and the plaintiff's harm. *See Bastian v. Petren Resources Corp.,* 892 F.2d 680, 686 (7th Cir.), *cert. denied,* —U.S.—, 110 S.Ct. 2590, 110 L.Ed.2d 270 (1990) ("'loss causation' is an exotic name — perhaps an unhappy one,[6] ... for the standard rule of tort law that the plaintiff must allege and prove that, but for the defendant's wrongdoing, the plaintiff would not have incurred the harm of which he complains."). *Id.* at 685.

We conclude that the SIPC and the trustees must establish a causal connection between the alleged predicate acts of securities fraud and the losses they seek to recover. But in doing so, they need satisfy only the requirements of proximate cause as understood in a typical tort claim. *See Bastian,* 892 F.2d at 680, 683

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[6] As with the term "loss causation," there also appears to be a lack of universal happiness with the term "proximate cause."

> "Proximate cause" — in itself an unfortunate term — is merely the limitation which the courts have placed upon the actor's responsibility for the consequences of the actor's conduct. In a philosophical sense, the consequences of an act go forward to eternity, and the causes of an event go back to the dawn of human events, and beyond. But any attempt to impose responsibility upon such a basis would result in infinite liability for all wrongful acts, and would "set society on edge and fill the courts with endless litigation."

Prosser and Keeton on Torts § 41 at 264 (5th ed.1984) (quoting Mitchell, J., in *North v. Johnson,* 58 Minn. 242, 59 N.W. 1012 (1984)).

("Indeed what securities lawyers call 'loss causation' *is* the standard common law fraud rule (on which see Prosser and Keeton on the Law of Torts § 110, at p. 767 (5th ed.1984)), merely borrowed for use in federal securities fraud cases.").

[4] In the present case, the district court determined that the SIPC and the trustees did not show a sufficient causal connection between Holmes' acts and the losses they sought to recover. Summary judgment was granted in favor of Holmes on this basis. However, the district court also concluded that there was a genuine issue for trial as to whether Holmes participated in a conspiracy to manipulate the shares of the subject companies. Given this conclusion, the SIPC and the trustees, and the Securities and Exchange Commission in an amicus brief, argue that it was error for the district court to examine Holmes' conduct in isolation from the conduct of his coconspirators. We agree.

"All conspirators are liable for the acts of their coconspirators." *Beltz Travel Serv. v. International Air Transp. Ass'n,* 620 F.2d 1360, 1367 (9th Cir.1980). "[A] conspiracy is not to be judged by dismembering it and viewing its separate parts, but only by looking at it as a whole." *United States v. Patten,* 226 U.S. 525, 544, 33 S.Ct. 141, 145, 57 L.Ed. 333 (1913).

"Dismembering" the conspiracy seems to be what the district court did. In its conclusions of law, the district court stated:

> 3. The actions of Joe Lugo ("Lugo") [the chief financial officer of FSSC and an alleged coconspirator] constituted supervening events which interrupted any alleged causal chain between Holmes' conduct and FSSC's net capital deficiency.

4. The actions of Rodger Garrity and other Sebag brokers constituted supervening events which interrupted any alleged causal chain between Holmes' conduct and Sebag's net capital deficiency.

5. Plaintiffs' losses were caused by the actions of Lugo and the Sebag brokers.

10. Holmes is not legally responsible for Lugo's decision to not repay Nettie Vigman [an alleged coconspirator] from the monies earned from the resale of her shares of Aero Systems to other brokers, and for his subsequent decision to borrow money instead of to sell inventory to repay her.

11. Holmes is not legally responsible for the decisions of Lugo and the Sebag brokers to pledge Aero Systems stock as collateral for loans.

12. Holmes is not legally responsible for the decisions of Lugo and the Sebag brokers to use funds they allegedly earned from selling Aero Systems stock for improper purposes.

If Holmes conspired with these codefendants, and if the codefendants caused the alleged injuries, then Holmes is legally responsible. He need not have participated in every detail of the conspiracy. *See Beltz,* 620 F.2d at 1367. Thus, if the district court properly concluded that there was a genuine issue as to whether Holmes conspired to violate RICO, the district court erred in granting Holmes' motion for summary judgment based on a conclusion that his conduct alone did not proximately cause the injuries alleged.

[5, 6] In an attempt to avoid this result, Holmes argues the district court erred in determining that a genuine issue of material fact existed as to whether he participated in a conspiracy to violate RICO. The district court

based its determination on the declarations of two experts and a summary of the evidence contained in a "statement of background and facts" detailing how Holmes allegedly conspired with Lugo, Seymour Vigman [an officer, a shareholder, and the executive committee chairman of Bunnington], and others to manipulate the stock prices of Aero and Bunnington.

Holmes contends that the experts' declarations refer to documents not attached to or identified in the declarations. He also argues that the declarations contain the experts' opinions and conclusions regarding ultimate issues of fact and legal principles.

The district court's decision to consider the experts' declarations was an evidentiary decision. Evidentiary decisions are reviewed for abuse of discretion. *Kisor v. Johns-Manville Corp.,* 783 F.2d 1337, 1340 (9th Cir.1986). A district court has broad discretion in admitting expert testimony, and its decision will be sustained unless it is manifestly erroneous. *Taylor v. Burlington N. R.R.,* 787 F.2d 1309, 1315 (9th Cir.1986).

The Federal Rules of Evidence permit experts wide latitude in the scope and substance of their testimony. Rules 702 and 704 allow an expert to testify in the form of an opinion, even if it is on an ultimate issue of fact, if the expert's specialized knowledge may assist the trier of fact. Rule 703 allows an expert to base an opinion on facts made known to the expert before or at the hearing, and the facts need not be admissible in evidence so long as they are the type reasonably relied upon by experts in the field. Rule 705 permits an expert to give opinion testimony without prior disclosure of the underlying facts, unless the court requires otherwise.

Here, Holmes makes no argument that the experts do not have the specialized knowledge of the securities industry necessary to assist the trier of fact. *Cf. Shad v. Dean Witter Reynolds, Inc.*, 799 F.2d 525, 530 (9th Cir.1986) (introduction of expert testimony is essential to assist the jury in a churning case). Holmes claims that the two experts included opinions as to ultimate issues of fact, but does not claim that the experts failed to explain how they arrived at these conclusions. *Cf. Bieghler v. Kleppe*, 633 F.2d 531, 533 (9th Cir.1980) (expert's affidavit gave more than a bare conclusion that defendants had been negligent and that this negligence caused the accident). Further, an expert is not required to disclose all of the facts underlying an opinion, including documents the expert has reviewed, unless a court so requires. *See Bulthuis v. Rexall Corp.*, 789 F.2d 1315, 1318 (9th Cir.1985) (per curiam). We conclude that the district court did not abuse its discretion in considering the experts' declarations.

[7] Holmes also challenges under Rule 56(e) the district court's consideration of the SIPC's and the trustees' "statement of background and facts," claiming that it is full of unsupported allegations. However, Rule 56(e) only governs affidavits.[7] The challenged statement consists of a set of allegations that the SIPC and the trustees contend are supported by the declarations of the two

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[7]Rule 56(e) provides:

> Supporting and opposing affidavits shall be made on personal knowledge, shall set forth such facts as would be admissible in evidence, and shall show affirmatively that the affiant is competent to testify to the matters stated therein. Sworn or certified copies of all papers or parts thereof referred to in an affidavit shall be attached thereto or served therewith.

Fed.R.Civ.P. 56(e).

experts and by a number of exhibits. The statement is not evidence, but instead is a guide to evidence presented to the court to assist it in considering the evidence in opposition to Holmes' motion for summary judgment. As such, the statement is not objectionable under Rule 65(e).

CONCLUSION

We conclude that the district court erred in applying the purchaser-seller standing limitation to the SIPC's RICO claim. We also conclude that the district court erred in granting summary judgment to Holmes because genuine issues exist as to whether Holmes participated in a conspiracy and whether the conspirators caused the harm alleged. The district court did not err in considering the experts' declarations as evidence or in using the statement of background and facts as a guide to the evidence.

We reverse the district court's grant of summary judgment, and remand this case to the district court for further proceedings consistent with this opinion.

REVERSED and REMANDED.

CASE NO. CV 83-4742-AWT (Tx)
[Consolidated Cases]

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

SECURITIES INVESTOR PROTECTION CORPORATION, et al.,
Plaintiffs,

vs.

SEYMOUR VIGMAN, et al.,
Defendants.

AND CONSOLIDATED ACTIONS.

DEFENDANT ROBERT G. HOLMES, JR.'S STATEMENT OF UNCONTROVERTED FACTS IN SUPPORT OF MOTION FOR SUMMARY JUDGMENT THAT SIPC LACKS STANDING TO ASSERT CLAIMS UNDER 1934 SECURITIES EXCHANGE ACT, SECTION 10(b) AND RULE 10b-5

DATE: October 17, 1988
TIME: : a.m.
PLACE: Courtroom of the
Honorable A. Wallace Tashima

JACK I. SAMET, a Member of, and
STEPHEN K. LUBEGA, an Associate of
BUCHALTER, NEMER, FIELDS & YOUNGER
A Professional Corporation
700 South Flower Street, Suite 700
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Attorneys for Defendant
ROBERT G. HOLMES, JR.

1. In July 1981, the Securities Investor Protection Corporation ("SIPC") commenced the liquidation of Joseph Sebag, Inc. ("Sebag") and First State Securities Corporation ("FSSC") (collectively referred to as the "brokers").

2. SIPC appointed Eugene W. Bell, and John L. Britton (who has since been succeeded by Laurence A. Schroeder) as trustees charged with the duty of liquidating the brokers and returning customer property in accordance with the Securities Investor Protection Act ("SIPA").

3. The trustee for FSSC has admitted that SIPC did not advance any funds to him as trustee to pay for any purchase of Aero Systems ("Aero") stock made prior to July 24, 1981. (Response of Plaintiff Laurence A. Schroeder, Successor Trustee for the Liquidation of First State Securities Corporation ("FSSC's Response") to Defendant Holmes' First Set of Requests For Admissions, ("RFA")) (*See* FSSC's Response to RFA No. 3).

4. The trustee for FSSC admitted that SIPC did not advance any funds to him to compensate any customer in cash for the value of any Aero Systems stocks missing from any customer's account. (FSSC's Response to RFA No. 5).

5. The trustee for FSSC admitted that there were no shares of Aero Systems stock missing from the account of any customer of FSSC as of July 24, 1981. (FSSC's Response to RFA No. 7).

6. The trustee for FSSC has no evidence that SIPC advanced any funds to him to pay for the purchase of any Aero Systems stock missing from any customer's account. (FSSC's Response to RFA No. 4).

7. The trustee for FSSC does not have any evidence that he purchased any Aero Systems stock to satisfy the net equity claim of any FSSC customer. (FSSC's Response to RFA No. 6).

8. The trustee for FSSC does not have any evidence that SIPC advanced funds to him to reimburse any FSSC customer to compensate such customer for the net equity in such customer's account before any alleged unauthorized transactions in Aero Systems, Inc. stock. (FSSC's Response to RFA No. 8).

9. The trustee for Sebag admitted that SIPC did not advance to him any funds to pay for any purchase of Aero Systems stock made prior to July 27, 1981. (Response of Plaintiff Eugene W. Bell, Trustee for the Liquidation of Joseph Sebag ("Sebag's Response") to Holmes First Set of Requests For Admissions ("RFA")). (*See* Sebag's Response to RFA No. 3.).

10. The trustee for Sebag admitted that SIPC did not advance any funds to him for the purchase of any Aero Systems stock missing from any customer's account. (Sebag Response to RFA No. 4).

11. The trustee for Sebag admitted that SIPC did not advance any funds to him in order to compensate any customer of Sebag in cash for the value of Aero Systems stock missing from any customer's account. (Sebag's Response to RFA No. 5).

12. The trustee for Sebag admitted that SIPC did not advance any funds to him for the purchase of any Aero Systems stock allegedly missing from any customer's account.

13. The trustee for Sebag admitted that there were no shares of Aero Systems stock missing from any account of

any customer of Sebag as of July 27, 1981. (Sebag's Response to RFA No. 7).

14. There is no evidence that SIPC advanced funds to the trustee for Sebag to reimburse any Sebag customer for the net equity in such customer's account before any alleged unauthorized transactions in Aero Systems, Inc. stock. (Sebag's Response to RFA No. 8).

15. There is no evidence that Holmes participated in, knew of, approved, or was otherwise involved in any unauthorized transactions by the principals of FSSC and Sebag, Joseph Lugo and Rodger Garrity, and/or their employees, in any security. (Holmes Depo. of 12-4-87, p. 267).

16. In liquidating the estates of the brokers, and administering the payment of brokerage customer claims, the trustee of Sebag took the view that SIPA did not authorize the trustees to compensate customer claims which were a result of fraud. (Letter from Trustee for Sebag to David E. Johns and Virginia D. Johns, dated March 22, 1982, attached as Exhibit "4" to Holmes Motion for Summary Judgment That SIPC Lacks Standing To Assert Claims Under The 1934 Securities Act (the "Standing Motion")).

17. In liquidating the estates of the FSSC and Sebag, the trustees routinely rejected claims by customers who alleged that they were victims of the brokers' fraud. (Exhibit "4" to the Standing Motion, Declaration of John Townley).

18. An example of such a determination by the trustees is a letter from the trustee for Sebag to David and

Virginia Johns dated March 22, 1982 stating, in part, that:

> "Your claim and the material, if any, which accompanied it raises serious questions as to the manner in which your account was handled by the debtor and your investment executive. I have given careful attention to your claim and the matters mentioned therein. However, I must determine your claim in accordance with the applicable provisions of SIPA and the judicial decisions interpreting that statute. Under my view of the law, charges of market manipulation, negligence, fraud or conduct such as that mentioned in your claim, even if true, are not recoverable under the provisions of SIPA or payable from advances by SIPC."

(*See* Exhibit to the Standing Motion).

19. In liquidating the estates of FSSC and Sebag, the trustees for the brokers made many determinations similar to that made in the case of David and Virginia Johns cited herein above. (*See* Exhibit " " to Standing Motion; Declaration of John Townley).

20. The information contained in SIPC's Form 34's prepared by the trustees for Sebag and FSSC in support of proposed distributions to customers and requests to SIPC to advance payments based on, *inter alia*, the calculation of a customer's net equity, indicated no advances from SIPC to the trustees for the purchase of any shares of Aero Systems stock for any customer's account or for the satisfaction of claims on account of missing Aero Systems securities in any customer's account. (Declaration of Stephen McKeand and John Townley and Exhibits " " to the Standing Motion).

CONCLUSIONS OF LAW

1. The implied right of action under Section 10(b) and Rule 10b-5 is available only to a plaintiff who is a purchaser or seller of securities in connection with the alleged securities law violation.

2. SIPC acquires standing as a purchaser/seller to recover on behalf of customers of failed securities brokerage firms only to the extent they are subrogated to the customer's right of recovery under Section 10b and Rule 10b-5.

3. SIPC is mandated by the Securities Investor Protection Act 15 U.S.C. § 78aaa, et seq., SIPA to make cash advances to customers when the failed broker's assets are insufficient to satisfy claims directly arising out of the insolvency and to reimburse customers for their "net equity".

4. SIPC has no standing to assert claims against Holmes under Section 10(b) and Rule 10b-5 of the 1934 Securities Exchange Act because SIPC has not proven that the broker used the customer's assets to make unauthorized purchases or sales of Aero Systems, Inc. securities, and that SIPC advanced cash to customers based upon the net equity of the account before unauthorized transactions.

5. It is insufficient for SIPC to allege that customer losses were caused by fraud or market manipulation in general. SIPC must demonstrate unauthorized transactions of Aero Systems, Inc. stock in the particular customer's account to be subrogated to that customer's rights under the Securities Exchange Act.

6. There is no evidence (SIPC having the burden under *Celotex*) that any pledge of fully-paid-for customer stock was "unauthorized".

DATED: August 12, 1988

Respectfully submitted,

JACK I. SAMET
STEPHEN K. LUBEGA
BUCHALTER, NEMER,
FIELDS & YOUNGER
A Professional Corporation

By _____
Stephen K. Lubega

IT IS SO ORDERED.
Dated: October 25, 1988

_____
A. WALLACE TASHIMA
United States District Judge

CASE NO. CV 83-4742-AWT

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

SECURITIES INVESTOR PROTECTION CORPORATION, et al.,
Plaintiffs,
v.
SEYMOUR VIGMAN, et al.,
Defendants.

[Consolidated Cases CV-83-4724-AWT (TX); CV-83-5674-AWT (Tx); and Bk. No. SA85-0083-PE Adv. No. SA85-0138-PE]

JUDGMENT (PROPOSED)

ORDER OF PARTIAL SUMMARY JUDGMENT

JACK I. SAMET, a Member of
STEPHEN K. LUBEGA, an Associate
BUCHALTER, NEMER, FIELDS & YOUNGER
A Professional Corporation
700 South Flower Street, Suite 700
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(213) 626-6700

Attorneys for ROBERT G. HOLMES, JR.

The Motion of Defendant Robert G. Holmes, Jr. for Summary Judgment That SIPC Lacks Standing to Assert Claims Under 1934 Securities Exchange Act, Section 10(b) and Rule 10b-5 came on regularly for hearing on October 24, 1988 at 1:30 p.m., before the Honorable A. Wallace Tashima, Judge for the United States District Court, Central District of California. Jack I. Samet, a member of Buchalter, Nemer, Fields & Younger, a Profes-

sional Corporation, appeared on behalf of Defendant Robert G. Holmes, Jr., Stephen Taylor and Robert Graham appeared on behalf of Plaintiffs.

After full consideration of the evidence, the points and authorities submitted by the parties and oral arguments of counsel, the Court finds, for good cause shown, that the Securities Investor Protection Corporation ("SIPC") lacks standing to assert claims under the Securities and Exchange Act of 1934 against Robert G. Holmes, Jr. Accordingly, SIPC's Second and Sixteenth claims for relief against Holmes, based upon Section 10(b) of the Securities and Exchange Act of 1934 and Rule 10b-5 promulgated thereunder, are dismissed in their entirety with prejudice.

DATED: October 25, 1988

The Honorable A. Wallace Tashima,
Judge for the United States
District Court

CASE NO. CV 83-4742-AWT (Tx)

UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF CALIFORNIA

SECURITIES INVESTOR PROTECTION CORPORATION, et al.,

Plaintiffs,

vs.

SEYMOUR VIGMAN, et al.,

Defendants.

AND CONSOLIDATED ACTIONS.

[Consolidated Cases]
CV-83-4742-AWT (Tx)
CV-83-5674-AWT (Tx)
and Bk. No. SA85-00083-PE;
Adv. No. SA85-0138-PE

STATEMENT OF UNCONTROVERTED FACTS AND CONCLUSIONS OF LAW (MOTION OF DEFENDANT ROBERT G. HOLMES, JR. FOR SUMMARY JUDGMENT ON ISSUE OF CAUSATION FILED CONCURRENTLY HEREWITH)

Date: October 17, 1988
Time:
Place: Courtroom of Honorable
A. Wallace Tashima

JACK I. SAMET, a Member of RICHARD P. WALKER, an Associate of
BUCHALTER, NEMER, FIELDS & YOUNGER
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Attorneys for Defendant Robert G. Holmes, Jr.

Filed Stamps
August 12, 1988, August 15, 1988 & October 31, 1988
Central District of California Clerk, U.S. District Court

Defendant Robert G. Holmes, Jr. ("Holmes") submits the following Statement of Uncontroverted Facts and Conclusions of Law pursuant to Rule 7.14.1 of the Local Rules of Practice for the United States District Court, Central District of California. The following includes every essential element necessary to entitle Holmes to judgment as a matter of law on all claims brought against him by Plaintiff Securities Investor Protection Corporation ("SIPC") and Plaintiff Trustees in this action, as set forth in the concurrently filed Motion for Summary Judgment on Issue of Causation.

UNCONTROVERTED FACTS

1. On July 21, 1981, First State Securities Corporation ("FSSC") ceased operations for violation of net capital requirements. (NASD Report, October 13, 1981, Exhibit "4" to the concurrently filed Exhibits to Motion of Defendant Robert G. Holmes, Jr. for Summary judgment on Issue of Causation (hereinafter "Exhibit __ hereto"), p. 1, para. 2.)

2. Because of FSSC's net capital deficiency, a trustee designated by SIPC was appointed on July 24, 1981 to liquidate the estate of FSSC, to pay customers of FSSC monies advanced by SIPC, and to perform other functions set forth in the Securities Investor Protection Act of 1970. (NASD Report, October 13, 1981, Exhibit "4" hereto, p. 2, para. 2.)

3. On July 21, 1981, Joseph Sebag, Inc. ("Sebag") ceased operations for violation of net capital rules. (NASD Report, October 16, 1981, Exhibit "5" hereto, p. 3, para. 1.)

4. Due to Sebag's net capital deficiency, a trustee designated by SIPC was appointed on July 27, 1981 to

liquidate the estate of Sebag, to pay customers of Sebag monies advance by SIPC, and to perform other functions pursuant to the Securities Investor Protection Act of 1970. (NASD Report, October 16, 1981, Exhibit "5" hereto, p. 4, para. 4.)

5. Sebag's trustee claims that Sebag's damages are at least $26,212,666.76. (Statement prepared by Eugene W. Bell, Trustee for the Liquidation of Joseph Sebag, Inc., Exhibit 10,043 to his deposition of September 2, 1987 and Exhibit "8" hereto.)

6. FSSC's trustee claims that FSSC's damages are at least $4,014,433.41. (Calculated from numbers indicated in Final Report of John L. Britton Trustee and in Successor Trustee's First Semi-Annual Report (collectively Exhibit "9" hereto).)

7. FSSC had 33,443 shares of Bunnington Corporation stock in its closing inventory. (NASD Report, October 13, 1981, Exhibit "4" hereto, p. 1, para. 3.)

8. Sebag had 73,640 shares of Bunnington Corporation stock in its closing inventory. (Exhibit 97-G to Foley Deposition and Exhibit "6" hereto.)

9. Bunnington stock dropped in price from $10⅛ per share to $2½ per share within three days after Sebag and FSSC were closed. (NASD Report, October 13, 1981, p. 1, para. 3-p. 2, para. 1.)

10. FSSC had 33,022 shares of Aerosonic Corporation stock in its closing inventory. (NASD Report, October 13, 1981, p. 1, para. 3-p. 2, para. 1.)

11. Sebag had 226,910 shares of Aerosonic Corporation stock in its closing inventory. (Exhibit 97-G to Foley Deposition and Exhibit "6" hereto.)

12. Aerosonic stock dropped in price from $11¼ per share to $5½ per share within three days after FSSC and Sebag were closed. (NASD Report, October 13, 1981, p. 1, para. 3-p. 2, para. 1.)

13. FSSC had no shares of Aero Systems stock in its closing inventory, and was 250 shares short in Aero Systems stock at that time. (Plaintiffs' Responses to Third Set of Interrogatories Propounded By Defendant Robert G. Holmes, Jr., Exhibit "3" hereto (hereinafter "Plaintiffs' Interrogatory Responses"), p. 3, l. 27-p. 4, l. 2.)

14. Sebag had 42 shares of Aero Systems stock in its closing inventory. (Plaintiffs' Interrogatory Responses, p. 4, ls. 13-15.)

15. The price of Aero Systems stock did not drop significantly after FSSC and Sebag were closed. (Memorandum, "Analysis of Firm Inventory [of Sebag] A/O 7-27-81 on the Seven Targeted Securities", Exhibit 97-B to the Foley Deposition and Exhibit "6" hereto.)

16. The National association of Securities Dealers (the "NASD") concluded that the large concentration of Bunnington and Aerosonic stock in FSSC's and Sebag's closing inventories was a substantial cause of the brokerage firms' failure. (NASD Report, October 13, 1981, pp. 1-3; NASD Report, October 16, 1981, pp. 2-4.)

17. On its reports regarding the cause of FSSC's and Sebag's failure, the NASD did not mention Aero Systems. (NASD Report, October 13, 1981; NASD Report, October 16, 1981.)

18. No monies were advanced by SIPC to the Trustees or to the customers of Sebag and FSSC in payment of customer claims with respect to unauthorized transactions by Sebag or FSSC in Aero Systems securities. (*See*

Holmes' concurrently filed Motion for Summary Judgment that SIPC Lacks Standing to Assert Claims Under 1934 Securities Exchange Act and evidence cited therein.)

19. SIPC and the Trustees would not have suffered the losses they are claiming in this action if FSSC and Sebag had complied with net capital requirements. (Foley Deposition, the relevant portions of which are Exhibit "1" hereto, Vol. VIII, p. 874, l. 24-p. 875, l. 2.)

20. FSSC's and Sebag's net capital deficiencies resulted from their undue concentration of Aerosonic and Bunnington stock in their inventories. (Foley Deposition, Vol. VIII, p. 870, ls. 16-20; p. 931, ls. 4-7; NASD Reports, October 13, 1981 (Exhibit "4" hereto) and October 16, 1981 (Exhibit "5" hereto).)

21. FSSC's and Sebag's net capital violations were caused by the brokerage firms' management. (Foley Deposition, Vol. VIII, p. 930, ls. 19-30.)

22. Any alleged manipulation of Aero Systems securities by Holmes or anyone else had no impact on FSSC's or Sebag's net capital deficiencies. (Foley Deposition, Vol. VIII, p. 877, l. 20-p. 878, l. 8.)

23. FSSC had a net capital deficiency by, at the latest, April 1981. (Plaintiff's Interrogatory Responses, Exhibit "3" hereto, p. 6, ls. 19-22.)

24. Plaintiffs claim that Sebag was in a net capital deficiency position by as early as March of 1980, and certainly no later than April of 1981. (Foley Deposition, Vol. VIII, p. 380, ls. 18-22.)

25. Plaintiffs claim that FSSC borrowed money to pay Nettie Vigman for her shares of Aero Systems on April 24

and May 29, 1981. (Plaintiffs' Interrogatory Responses, p. 7, ls. 12-15.)

26. FSSC had sufficient funds available to pay Nettie Vigman on the settlement date when she sold her shares of Aero Systems stock. (Foley Deposition, Vol. III, p. 420, ls. 13-15.)

27. The date FSSC allegedly pledged shares of Aero Systems stock as collateral for a loan was July 15, 1981 (Foley Deposition, Vol. V, p. 642, l. 19), and the date Sebag allegedly pledged Aero Systems stock as collateral was "as of July 27, 1981" (Plaintiffs' Interrogatory Responses, p. 9, l. 21.)

28. The decisions to use Aero Systems stock as collateral for a loan were the decisions of persons at FSSC and Sebag, not of Holmes. (Foley Deposition, Vol. V, p. 646, ls. 11-14 and p. 655, l. 25-p. 656, l. 5.)

29. Holmes never had an account with Sebag, never traded through Sebag, never had any business dealings with Sebag, and never had any relationship with Sebag more than a passing acquaintance with Rodger Garrity. (No evidence of any such connection with Sebag exists in the record.)

30. Sebag never had an undue concentration of Aero Systems stock in its inventory. (Foley Deposition, Vol. III, p. 385, ls. 17-21.)

31. The transaction in which Holmes allegedly parked Bunnington securities occurred after FSSC was in a net capital deficiency position. (Plaintiffs' Interrogatory Responses, p. 8, l. 24; Foley Deposition, Vol. V., P. 579, ls. 14-15.)

32. There is no evidence that Holmes knowingly, willfully or intentionally participated in a "scheme" to con-

trol the floating supply of Bunnington Corporation stock by purchasing the stock in early May of 1981. (Foley Deposition, Vol. VI, p. 718, l.25-p. 720, l. 7.)

33. There is no evidence that Holmes knowingly, willfully, or intentionally assisted FSSC in evading net capital restrictions by "parking" shares of Bunnington Corporation stock in May of 1981. (Deposition of Robert G. Holmes, Jr., May 6, 1988, p. 2820, l. 22-p. 2822, l. 6 and p. 2839, l. 22-p. 2849, l. 25, Exhibit "2" hereto.)

34. The alleged parking transaction did not put FSSC into capital violation. (Foley Deposition, Vol. III, p. 354, ls. 9-11.)

35. The effect of parking is to hide, not cause, a net capital deficiency. (Foley Deposition, Vol. II, p. 185, l. 24-p. 186, l. 15; Vol. V, p. 596, ls. 6-16.)

36. The alleged parking transaction by Holmes was not a cause of FSSC's net capital deficiency. (Foley Deposition, Vol. V, p. 598, ls. 20-23.)

CONCLUSIONS OF LAW

1. Holmes' actions were not the direct, proximate, or legal cause of FSSC's net capital deficiency.

2. Holmes' actions were not the direct, proximate, or legal cause of Sebag's net capital deficiency.

3. The actions of Joe Lugo ("Lugo") constituted supervening events which interrupted any alleged causal chain between Holmes' conduct and FSSC's net capital deficiency.

4. The actions of Rodger Garrity and other Sebag brokers constituted supervening events which interrupted

any alleged causal chain between Holmes' conduct and Sebag's net capital deficiency.

5. Plaintiffs' losses were caused by the actions of Lugo and the Sebag brokers.

6. There is no genuine issue for trial against Holmes on loss causation.

7. FSSC's and Sebag's holdings of Aero Systems stock were not material to the brokerage firms' financial conditions, and did not contribute to their net capital deficiencies.

8. Any alleged manipulation of Aero Systems stock price did not contribute to the net capital deficiencies.

9. Aero Systems was not connected to the net capital deficiencies of FSSC and Sebag.

10. Holmes is not legally responsible for Lugo's decision to not repay Nettie Vigman from the monies earned from the resale of her shares of Aero Systems to other brokers, and for his subsequent decision to borrow money instead of to sell inventory to repay her.

11. Holmes is not legally responsible for the decisions of Lugo and the Sebag brokers to pledge Aero Systems stock as collateral for loans.

12. Holmes is not legally responsible for the decisions of Lugo and the Sebag brokers to use funds they allegedly earned from selling Aero Systems stock for improper purposes.

13. Events which occurred after FSSC's and Sebag's capital was already impaired and deficient, including all of the events set forth in Plaintiffs' Causation Allegations, did not cause the impairment to happen.

14. A net capital increase cannot be the proximate cause of a net capital deficiency.

15. The direct effect of a manipulation of stock price is to increase net capital.

16. A source of funds is not a direct or proximate cause of the wrongs perpetrated by the user of the funds.

17. To mathematically decrease the floating supply of a stock by purchasing the stock does not render the purchaser a knowing or willing participant in a scheme to control the supply of the stock or to manipulate its price.

18. Holmes did not knowingly, intentionally, or willfully assist FSSC to evade net capital restrictions by his transaction of 5,000 shares of Bunnington Corporation stock in May of 1981.

19. The alleged parking transaction was not material to FSSC's financial position.

20. The alleged parking transaction by Holmes did not cause FSSC's net capital deficiency.

21. A claim that parking enables a brokerge firm to evade net capital restrictions fails to raise a triable issue on loss causation.

22. Holmes is entitled to judgment as a matter of law on all claims brought by Plaintiff Securities Investor Protection Corporation and Plaintiff Trustees.

23. The proximate cause requirement under RICO, *e.g., Haroco v. American Nat'l. Bank & Trust Co.*, 747 F.2d 384, 398 (7th Cir. 1984), is, in substance, no different than the "loss causation" requirement under the securities laws, when the predicate acts on which the RICO

violation is based is securities fraud. *E.g., Sperber v. Boesky,* 849 F.2d 60 (2d Cir. 1988).

Dated: August 12, 1988

JACK I. SAMET
RICHARD P. WALKER
BUCHALTER, NEMER,
FIELDS & YOUNGER
A Professional Corporation

By _____
RICHARD P. WALKER
Attorneys for Defendant
Robert G. Holmes, Jr.

IT IS SO ORDERED.
Dated: October 28, 1988

_____
A. WALLACE TASHIMA
United States District Judge

CASE NO. CV 83-4742-AWT (Tx)

UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF CALIFORNIA

SECURITIES INVESTOR PROTECTION CORPORATION et al.,

Plaintiffs,

vs.

SEYMOUR VIGMAN, et al.,

Defendants.

AND CONSOLIDATED ACTIONS.

[Consolidated Cases
CV-83-4742-AWT (Tx)
CV-83-5674-AWT (Tx)
and Bk. No. SA85-00083-PE;
Adv. No. SA85-0138-PE]

SUMMARY JUDGMENT (HOLMES)

Date: October 17, 1988
Time:
Place: Courtroom of the Honorable
A. Wallace Tashima

JACK I. SAMET, a Member of
JOVINA R. HARGIS, a Member of
RICHARD P. WALKER, an Associate of
BUCHALTER, NEMER, FIELDS & YOUNGER
A Professional Corporation
700 South Flower Street, Suite 700
Los Angeles, California 90017-4183
(213) 626-6700

Attorneys for Defendant Robert G. Holmes, Jr.

Filed Stamps
August 2, 1988 & October 31, 1988
Clerk, U.S. District Court Central District of California

The Motion of Defendant Robert G. Holmes, Jr. for Summary Judgment on Issue of Causation came on regularly for hearing on October ~~17~~ 24, 1988, before the Honorable A. Wallace Tashima, Judge for the United States District Court, Central District of California. Jack I. Samet, a member of Buchalter, Nemer, Fields & Younger, a Professional Corporation, appeared on behalf of Defendant Robert G. Holmes, Jr., and Stephen Taylor and Robert Graham appeared on behalf of Plaintiffs.

After full consideration of the evidence and Points and Authorities submitted by both parties, and oral arguments of counsel, it appears and the Court finds that Defendant Robert G. Holmes, Jr. did not cause the damages alleged by Plaintiffs in this action, that there is no triable issue of any material fact with respect to the requirement of loss causation, and that Holmes is accordingly entitled to judgment as a matter of law.

IT IS HEREBY ORDERED that this Motion for Summary Judgment is granted and judgment shall be entered forthwith as requested in the Motion in favor of Defendant Robert G. Holmes, Jr. and against Plaintiffs.

The Clerk of the Court is hereby ordered to enter this judgment.

Dated: October 28, 1988

Honorable A. Wallace Tashima
United States District Judge

CASE NO. CV 83-4742-AWT (Tx)

UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF CALIFORNIA

SECURITIES INVESTOR PROTECTION CORPORATION et al.,

Plaintiffs,

vs.

SEYMOUR VIGMAN, et al.,

Defendants.

AND CONSOLIDATED ACTIONS.

[Consolidated Cases]

ORDER GRANTING SUMMARY JUDGMENT (RICO CLAIMS)

Date: October 17, 1988
Time: : a.m.
Place: Courtroom of the Honorable A. Wallace Tashima

JACK I. SAMET, a Member of, and
STEPHEN K. LUBEGA, an Associate of
BUCHALTER, NEMER, FIELDS & YOUNGER,
A Professional Corporation
700 South Flower Street, Suite 700
Los Angeles, California 90017-4183
(213) 626-6700

Attorneys for Defendant Robert G. Holmes, Jr.

Filed Stamp
October 31, 1988
Clerk U.S. District Court
Central District of California

The Motion of Defendant Robert G. Holmes, Jr. for Summary Judgment With Respect To Claims Asserted

Under The Racketeer Influenced and Corrupt Organizations Act ("RICO"), came on regularly for hearing on October ~~17~~ 24, 1988 at , before the Honorable A. Wallace Tashima, Judge for the United States District Court, Central District of California. Jack I. Samet, a member of Buchalter, Nemer, Fields & Younger, a Professional Corporation, appeared on behalf of Defendant Robert G. Holmes, Jr., and appeared on behalf of Plaintiffs.

After full consideration of the evidence and the Points and Authorities submitted by the parties, and oral arguments of counsel, it appears and the Court finds, that although there is genuine dispute regarding material facts with respect to the following issues; i.e., whether:

1. There is no identifiable "racketeering enterprise" that is separate and distinct from the alleged pattern of racketeering activity.

2. ~~There is no evidence that~~ Robert G. Holmes, Jr. invested any income derived from a pattern of racketeering activity in an enterprise engaged in interstate commerce.

3. ~~There is no evidence that~~ Robert G. Holmes, Jr. acquired, through a pattern of racketeering activity, an interest in or control of an enterprise.

4. ~~There is no evidence that~~ Robert G. Holmes, Jr. was employed or associated with an enterprise and conducted the affairs of the enterprise through a pattern of racketeering activity.

5. ~~There is no evidence that~~ Robert G. Holmes, Jr. conspired to violate RICO Sections 1962(a); 1962(b); or 1962(c).

6. ~~There is no evidence that~~ the alleged "predicate acts" are offenses involving fraud in the sale of securities or bankruptcy fraud under Title 11, U.S.C., or are indictable as mail or wire fraud under Title 18, U.S.C. §§ 1341, 1343. The alleged "predicate acts" are not therefore "racketeering activity" as defined under RICO Section 1961(1).

7. ~~There is no evidence that~~ at least two "predicate acts" occurring within ten years of each other which meet the criteria of relatedness and continuity to constitute a "pattern" of racketeering activity.

8. The alleged predicate acts did not cause the injuries of the Securities Investor Protection Corporation ("SIPC") and/or the injuries of the Trustees appointed by SIPC to liquidate Joseph Sebag, Inc. and First State Securities Corporation.

However, there is no genuine dispute that:

9. SIPC does not meet the "purchaser-seller" requirements for standing to assert RICO claims which are predicated upon violation of Section 10(b) and Rule 10b-5 of the 1934 federal Securities Exchange Act.*

IT IS HEREBY ORDERED that Defendant G. Holmes, Jr.'s Motion for Summary Judgment With Respect To Claims Asserted Under The Racketeer Influenced and Corrupt Organizations Act is granted and ~~judgment shall be entered forthwith as dismissing~~ such claims ~~requested in Motion~~ are hereby DISMISSED.

~~The clerk of the Court is hereby ordered to enter this judgment.~~

*Note: The grant of summary judgment on "causation" applies also to the RICO claims.

DATED: October 28, 1988

Honorable A. Wallace Tashima
United States District Judge

SECURITIES INVESTOR PROTECTION CORPORATION,
Plaintiff-Appellant,
v.
SEYMOUR VIGMAN, et al.,
Defendants-Appellees.
No. 85-5786.
United States Court of Appeals,
Ninth Circuit.
Argued and Submitted April 7, 1986.
Submission Withdrawn July 14, 1986.
Resubmitted November 7, 1986.
Decided November 7, 1986.

In securities fraud action, appeal was taken from order dismissing four of 75 defendants on grounds that court lacked personal jurisdiction and that venue was improper. The Court of Appeals, 764 F.2d 1309, reversed and remanded. On remand, the United States District Court for the Central District of California, A. Wallace Tashima J., dismissed Securities Investor Protection Corporation's securities fraud claims, and SIPC appealed. The Court of Appeals, Eugene A. Wright, Circuit Judge, held that Securities Investor Protection Corporation had standing

to bring securities fraud action against 75 defendants who allegedly engaged in the scheme only if it reimbursed a customer for cash or securities the brokers were supposed to be holding.

Reversed and remanded.

1. Securities Regulation — 185.10

Securities Investor Protection Corporation is a nonprofit corporation created by the Securities Investor Protection Act of 1970; it protects, from broker's financial failure, customers of securities brokers by insuring the net equity of customers' accounts up to specified maxima. Securities Investor Protection Act of 1970, §§ 1(a)-16, 9(a), 16(11), as amended 15 U.S.C.A. §§ 78aaa to 78*lll*, 78fff-3(a), 78*lll*(11).

2. Securities Regulation — 185.13

Under Securities Investors Protection Act, trustee may be appointed to return customer property, complete open transactions, enforce rights of subrogation and liquidate business of brokerage; Securities Investor Protection Corporation is required to advance the trustee necessary funds to complete open transactions and return customer property up to specified maxima. Securities Investor Protection Act of 1970, §§ 5(b)(3), 7, 8, 9(a), 10(c), as amended, 15 U.S.C.A. §§ 78eee(b)(3), 78fff-1, 78fff-2, 78fff-3(a), 78fff-4(c).

3. Securities Regulation — 185.16

If customers of liquidated brokerage could have recovered on Exchange Act securities fraud claim for monies advanced, then Securities Investor Protection Corporation, as subrogee of customers, could do so. Securities Investor Protection Act of 1970, §§ 5(b)(3), 7, 8, 9(a),

10(c), as amended, 15 U.S.C.A. §§ 78eee(b)(3), 78fff-1, 78fff-2, 78fff-3(a), 78fff-4(c).

4. Securities Regulation — 60.15

Securities Investor Protection Corporation did not meet "purchase-or-sale" requirement for standing to bring private securities fraud action following liquidation of two securities brokerages, based on theory that when it paid customers value of missing securities, it constructively purchased them; declining to follow *Rich v. Touche Ross & Co.*, 415 F.Supp. 95 (S.D.N.Y.). Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b).

5. Securities Regulation — 60.15

Under "aborted seller or purchaser doctrine," if plaintiff had contract to buy or sell a security, contract right will satisfy the *Birnbaum* rule, requiring purchase or sale of a security for standing to bring securities fraud action, even if contract were breached. Securities Act of 1933, § 17(a), 15 U.S.C.A. § 77q(a); Securities Exchange Act of 1934, §§ 3(a)(13, 14), 10(b), 15 U.S.C.A. §§ 78c(a)(13, 14), 78j(b).

See publication Words and Phrases for other judicial constructions and definitions.

6. Securities Regulation — 60.15, 60.37

Under "pledge doctrine" when stock is pledged as collateral for a loan, pledgor has constructively sold the stock and pledgee constructively bought it, even though no foreclosure has taken place, for purposes of *Birnbaum* rule, requiring purchase or sale of security for standing to bring securities fraud action. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b).

See publication Words and Phrases for other judicial constructions and definitions.

7. Securities Regulation — 60.15

Under *Birnbaum* rule, requiring purchase or sale of security for standing to bring securities fraud action, there is equivalent of a forced sale whenever shareholder's investment substantially changes in character or when shareholder is forced to accept liquidated value for his shares. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b).

8. Securities Regulation — 60.15

Securities Investor Protection Corporation, after liquidating two securities brokerages which allegedly failed as result of fraudulent stock market manipulation scheme, did not have standing to bring securities fraud action against defendants who allegedly engaged in the scheme under "aborted seller," "pledge," and "forced sale" doctrines, as exceptions to *Birnbaum* rule, requiring purchase or sale of security for standing to bring securities fraud action. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b).

9. Securities Regulation — 60.15, 60.37

When broker makes unauthorized purchase or sale of securities with his customer's assets, that purchase or sale may be attributed to the customer for purposes of satisfying the *Birnbaum* rule, requiring purchase or sale of a security for standing to bring securities fraud action. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b).

10. Securities Regulation — 60.36

Securities Investor Protection Corporation, after liquidating two brokerages which allegedly failed as result of fraudulent stock market manipulation scheme, had standing to bring securities fraud action against 75 defendants who allegedly engaged in the scheme, only if it reimbursed a customer for cash or securities the brokers were supposed to be holding, that is, net equity of customer's account before unauthorized transactions. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b).

Roy G. Wuchitech, Sheppard, Mullin, Richter & Hampton, Los Angeles, Cal., for plaintiff-appellant.

David L. Ross, Greenberg, Traurig, Askew, Hoffman, Lipoff, Rosen & Quentel, P.A., Miami, Fla., for defendants-appellees.

Appeal from the United States District Court for the Central District of California.

Before WRIGHT, NELSON and KOZINSKI, Circuit Judges.

EUGENE A. WRIGHT, Circuit Judge:

Seventy-five defendants allegedly engaged in a fraudulent scheme of stock market manipulation that ultimately caused the failure of two securities brokerages and the loss of many of the brokerage customers' securities and cash. Appellant, Securities Investor Protection Corporation (SIPC), liquidated the brokerages and reimbursed their customers for the value of the cash and securities as of the liquidation.

SIPC sued the brokers and the third-party defendants as subrogee of the brokers' customers and in its own right. It alleged several theories of liability, one being

securities fraud under Section 10(b) and Rule 10b-5 of the Securities Exchange Act of 1934, 15 U.S.C. §§ 78j(b) (1982); 17 C.F.R. § 240.10b-5 (1984) (the Exchange Act claims). The court dismissed the Exchange Act claims on the ground that SIPC could not satisfy the purchase-or-sale requirement of an Exchange Act securities fraud claim.

PROCEDURAL BACKGROUND

In July 1981, SIPC instituted liquidation proceedings against two securities brokerages, First State Securities Corporation (FSSC) and Joseph Sebag Incorporated (Sebag) (collectively "the brokerages" or "the brokers"). SIPC brought suit in July 1983, after disbursing the brokerages' assets and reimbursing their customers for the difference between their statutory claims and the brokerage assets. The complaint alleged, among other claims, securities fraud in violation of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. *See Securities Investor Protection Corporation v. Vigman*, 764 F.2d 1309, 1312 (9th Cir.1985) (previous appeal of this case, reversing and remanding dismissal, based on personal jurisdiction and venue, of two defendants).

The district court consolidated *Cain v. Vigman*, No. CV-83-5674-AWT (C.D.Cal.) with SIPC's action. The *Cain* case is a class action by the brokerages' customers against the defendants. After allowing an amendment to SIPC's complaint, the district court orally granted the defendants' consolidated motion under Fed.R.Civ.P. 12(b)(6) to dismiss SIPC's Exchange Act claims, holding that SIPC lacked standing to assert those claims. The court reasoned that the *Cain* class would "be the more appropriate plaintiff." It entered final judgment on those claims under Fed.R.Civ.P. 54(b).

SIPC appealed. After we heard oral argument and submitted the appeal for decision, we withdrew submission to allow the parties to submit supplemental briefs on several questions that we propounded. The Securities Exchange Commission submitted an amicus brief, which we found helpful. We now order the appeal resubmitted for decision.

FACTS

SIPC alleges that,a from 1964 through July 1981, the defendants engaged in a scheme to inflate the prices for the stocks of six companies. The scheme was carried out by cooperation among the defendants, who were officers and directors of the six companies and principals and employees of the brokerages.

SIPC alleges that the six companies' prospects were misrepresented through statements by company officials, press releases and financial statements. The illusion of active markets in the six stocks was allegedly maintained by misleading transactions in the defendants' accounts, in the brokerage proprietary accounts, and in accounts of unsuspecting customers.

When the scheme was uncovered, the prices of the six stocks fell drastically. Because the defendants had allegedly prostituted the brokerages by loading the proprietary accounts with the stock of the six companies, SIPC placed the brokerages under a protective decree in July 1981. In the process of liquidating the brokerages, SIPC allegedly had to disburse nearly $13 million to meet customers' claims for which the brokerages' assets were insufficient.

STANDARD OF REVIEW

This court reviews *de novo* a dismissal for failure to state a claim. *Robertson v. Dean Witter Reynolds, Inc.*, 749 F.2d 530, 533 (9th Cir.1984). The dismissal will be affirmed only if it appears beyond doubt that under no set of facts could the plaintiff be entitled to relief. *See Conley v. Gibson,* 355 U.S. 41, 45-46, 78 S.Ct. 99, 101-02, 2 L.Ed.2d 80 (1957); *Simon Oil Co. v. Norman,* 789 F.2d 780, 781 (9th Cir. 1986).

ANALYSIS

A. *Extent of SIPC Subrogation*

In their briefs, the parties argued vigorously over the extent of SIPC's subrogation rights. At oral argument, they seemed to agree on this question. But we set forth briefly the law on this subject to avoid misunderstanding.

[1] SIPC is a nonprofit corporation created by the Securities Investor Protection Act of 1970, as amended, 15 U.S.C. §§ 78aaa-78*lll* (1982) (SIPA). It protects, from a broker's financial failure, the customers of securities brokers by insuring the net equity of customers' accounts up to specified maxima. *See Touche Ross & Co. v. Redington,* 442 U.S. 560, 564-65 n. 5, 99 S.Ct. 2479, 2483, 61 L.Ed.2d 82 (1979).

SIPC is obligated to insure only the value of brokerage customers' "net equity" as of the initiation of the liquidation proceedings. *See* 15 U.S.C. §§ 78fff-3(a), 78*lll*(11) (1982). "Net equity" is a term defined in the Securities Investor Protection Act (SIPA). *See* 15 U.S.C. § 78*lll*(11) (1982). It is the amount that the broker would have owed each customer had it liquidated all the customer's holdings on the date the SIPC filed for a protec-

tive decree, less any outstanding debt the customer owed to the broker. *Id.*

[2, 3] Under SIPA, a trustee may be appointed to return customer property, complete open transactions, enforce rights of subrogation and liquidate the business of the brokerage. 15 U.S.C. §§ 78eee(b)(3), 78fff-1, 78fff-2; *see SIPC v. Barbour,* 421 U.S. 412, 417, 95 S.Ct. 1733, 1737, 44 L.Ed.2d 263 (1975). SIPC is required to advance the trustee necessary funds to complete open transactions and return customer property up to specified maxima. *Barbour,* 421 U.S. at 417, 95 S.Ct. at 1737; *see also Touche Ross & Co. v. Redington,* 442 U.S. 560, 564-65 n. 5, 99 S.Ct. 2479, 2483, 61 L.Ed.2d 82 (1979) (description of SIPC); *SEC v. Securities Northwest, Inc.,* 573 F.2d 622, 624 (9th Cir.1978) (same). To the extent SIPC advances funds, either to the trustee or directly to brokerage customers, it is subrogated to customers' claims. 15 U.S.C. §§ 78fff-3(a), 78fff-4(c). If customers could have recovered on an Exchange Act securities fraud claim for the monies advanced, then SIPC, as subrogee, could do so.

B. *Securities Fraud Claims*

The district court dismissed SIPC's Exchange Act claims because SIPC could not meet the purchase-or-sale requirement for standing to bring a private cause of action under Rule 10b-5.

SIPC asserts that the customers could have stated Exchange Act claims for the losses they would have suffered, had SIPC not reimbursed them. Instead of alleging specific purchases or sales that were tainted by the fraudulent scheme, however, SIPC contends that it may rely on any purchase or sale that was "touched" by fraud, *Superintendent of Insurance v. Bankers Life and*

Casualty Co., 404 U.S. 6, 12-13, 92 S.Ct. 165, 168-69, 30 L.Ed.2d 128 (1971), to support its claims for the missing funds and securities. "The touch test, however, is nothing more than a restatement of the 'in connection with' test." *In re Financial Corp. of America,* 796 F.2d 1126, 1130 (9th Cir.1986).

1. ***Birnbaum** Rule*

[4] In *Blue Chip Stamps v. Manor Drug Stores,* 421 U.S. 723, 95 S.Ct. 1917, 44 L.Ed.2d 539 (1975), the Court adopted the *Birnbaum* rule, which requires a purchase or sale of a security for standing to sue on an implied cause of action under Section 10(b) of the Exchange Act and Rule 10b-5. *See also Mosher v. Kane,* 784 F.2d 1385, 1388 (9th Cir.1986). Under the *Birnbaum* rule, in order for SIPC to have stated an adequate subrogation claim, the fraud *loss* must be *connected to* the *purchase* or *sale* of a security before the customers were fully aware of the facts and before the deception had ended. *See Shivers v. Amerco,* 670 F.2d 826, 830 (9th Cir.1982) (citing *Ohashi v. Verit Industries,* 536 F.2d 849, 852-53 (9th Cir.), *cert. denied,* 429 U.S. 1004, 97 S.Ct. 538, 50 L.Ed.2d 616 (1976); and *O'Brien v. Continental Illinois National Bank & Trust Co.,* 593 F.2d 54, 58 (7th Cir.1979)).

SIPC's argument, that it may rely on any sale or purchase made by customers during the time of the alleged fraudulent activity, does not persuade us. The fraud that it alleges must be casually related to the claims to which it is subrogated. *See Hatrock v. Edward D. Jones & Co.,* 750 F.2d 767, 773 (9th Cir.1984). Furthermore, it is not enough to say merely that the fraud caused the liquidation of the brokerage firm. *See In re Financial Corp. of America,* 796 F.2d at 1130 (discussing the causation element of the "in connection with" requirement).

The liquidation could have resulted in no subrogation at all had the customers' net equity claims been met by brokerage assets.[1]

[1]Without more, had the brokerages held every share of stock they should have, there would have been no subrogation link to *securities* at all, regardless of how much cash was missing or how little the shares of the stock were worth. SIPC is required to reimburse customers for the value of the securities "as of the close of business on the filing date." 15 U.S.C. § 78fff-2(c)(1). In reimbursing customers for their securities, it has the option of delivering the named securities, or securities of the same description. *See SEC v. Alberl & Maguire Securities Co.*, 560 F.2d 569, 573 (3d Cir.1977); *Rich v. Touche Ross & Co.*, 415 F.Supp. 95, 99-100 (S.D.N.Y.1976); *SEC v. S.J. Salmon & Co.*, 375 F.Supp. 867, 870-71 (S.D.N.Y.1974).

SIPC's allegations show a fraudulent market manipulation scheme which, if true, might support securities fraud recoveries for those in the class action who bought stock at inflated prices and held either the stock or a net equity claim for it when prices fell.

For example, if a broker used fraudulent means to convince a customer to purchase a stock and the customer left that stock with the broker, who subsequently became insolvent, SIPC would be required by SIPA only to return the stock to the customer. 15 U.S.C. § 78fff-2(c)(2); *see also In re June S. Jones Co.*, 52 B.R. 810 (D.Or.1985). The customer would retain any securities fraud claim against the broker for inducing the purchase.

If the stock in question were missing from the broker's inventory of stocks, SIPC could return to the customer the value of the stock as of the date of filing a protective decree, 15 U.S.C. § 78fff-2(b), or, if it could purchase the stock in an orderly market, SIPC could deliver other shares of the same class in the same company to satisfy the customer's claim, 15 U.S.C. § 78fff-2(d). Here too, the customer would retain any securities fraud claim against the broker for inducing the original purchase. SIPC would be entitled to assert a claim, though not necessarily a securities fraud claim, against the broker for the missing stock.

The importance of the proper allocation of claims is evident by the consolidated class action pending before the district court, in which

SIPC contends that when it paid customers the value of missing securities, it constructively purchased them, and may now sue in its own right as purchaser. *See Rich v. Touche Ross & Co.*, 415 F.Supp. 95, 99-100 (S.D.N.Y.1976) (holding that "SIPC liquidation qualifies as a sale" with respect to the customer, "where and to the extent customers' claims to specific shares are satisfied in cash"). We decline to accept this argument. Contrary to the holding in *Rich*, the SIPC liquidation did not "convert" securities into cash, as the securities had disappeared before liquidation. SIPC never received securities for its "purchase price." Garden variety conversion of securities does not become a purchase or sale merely because an insurer has later reimbursed the loss.

To further support its Exchange Act claims, SIPC alleges specific fraudulent transactions by the brokerages. It also contends, under a theory resembling *res ipsa loquitur*, that its payment of nearly $13 million to meet the customers' net equity claims should support an Exchange Act claim. These allegations fail to support a claim under a strict application of the *Birnbaum* rule.

2. *Exceptions to* **Birnbaum** *Rule*

The *Birnbaum* rule has not been applied without flexibility, as the Court recognized in *Bule Chip Stamps*, 421 U.S. at 751, 95 S.Ct. at 1932. *See also In re Financial Corp. of America*, 796 F.2d at 1129 (quoting *Arrington v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 651 F.2d 615, 619 (9th Cir.1981)). Three doctrines that ease the strictures of the *Birnbaum* rule have developed.

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the brokerage customers are pressing claims against the defendants. The class action claims, however, are not before us.

a. *Aborted Seller*

[5] The first is the aborted seller or purchaser doctrine. This proceeds on the strength of § 3(a)(13)-(14) of the Exchange Act, which includes contracts to purchase and contracts to sell within the definitions of "purchase" and "sell." 15 U.S.C. § 78c(a)(13)-(14). *See Ohashi*, 536 F.2d at 853 (quoting *Mount Clemens Industries, Inc. v. Bell*, 464 F.2d 339, 345 (9th Cir.1972)). If a plaintiff had a contract to buy or sell a security, the contract right will satisfy the *Birnbaum* rule, even if the contract were breached. *Mosher v. Kane*, 784 F.2d 1385, 1389 n. 5 (9th Cir.1986). *But see Lewelling v. First California Co.*, 564 F.2d 1277, 1279 (9th Cir.1977) (aborted seller does not satisfy *Birnbaum* if plaintiff-seller induced to *retain* securities through defendants' fraud).

b. *Pledge Seller*

[6] The second modification of the *Birnbaum* rule is the pledge doctrine. Under this doctrine, when stock is pledged as collateral for a loan, the pledgor has constructively sold the stock and the pledgee constructively bought it, even though no foreclosure has taken place. *See Rubin v. United States*, 449 U.S. 424, 429-31, 101 S.Ct. 698, 701-02, 66 L.Ed.2d 633 (1981) (pledge is a "sale" for purposes of fraud claim under § 17(a) of Securities Act of 1933); *United States v. Kendrick*, 692 F.2d 1262, 1265 (9th Cir.1982) (pledge of securities constitutes a sale under Rule 10b-5), *cert. denied*, 461 U.S. 914, 103 S.Ct. 1892, 77 L.Ed.2d 282 (1983). *But see In re Financial Corp. of America*, 796 F.2d at 1130 (insufficient that defendant " 'has committed a proscribed act in a transaction of which the pledge of a security is a part' ") (quoting *Chemical Bank v. Arthur Andersen & Co.*, 726 F.2d 930, 943 (2d Cir.), *cert. denied*, 469 U.S. 884, 105 S.Ct. 253, 83 L.Ed.2d 190 (1984)).

c. *Forced Seller*

[7] The third doctrine ameliorating the *Birnbaum* rule is the forced seller doctrine which arose in connection with mergers in which a plaintiff alleged fraud in the procurement of the merger. *See Shivers v. Amerco*, 670 F.2d at 830 (discussing *Vine v. Beneficial Finance Co.*, 374 F.2d 627 (2d Cir.), *cert. denied*, 389 U.S. 970, 88 S.Ct. 463, 19 L.Ed.2d 460 (1967)). After a merger is approved, a stockholder, under most state laws, has two choices: exchange the original stock for the securities and/or cash specified as the purchase price in the merger agreement, or exercise statutory appraisal rights and have the court determine the value of the shares. *See, e.g., Vine*, 374 F.2d at 633-34. In either event, there is the equivalent of a forced sale whenever a shareholder's investment substantially changes its character or when a shareholder is forced to accept a liquidated value for his shares. *See Mosher*, 784 F.2d at 1389.

[8] Without modification, the application of none of these three doctrines is sufficient to overturn the district court's dismissal of SIPC's Exchange Act claims.

SIPC alleges that customers' requests to sell securities were ignored as a part of the defendants' fraudulent scheme. This does not give SIPC standing under the aborted seller doctrine. At most it provides the plaintiff class a claim for breach of the brokers' fiduciary duty. Further, the alleged failure to sell is not causally related to SIPC's net equity losses, because SIPC is required to reimburse customers only for the securities in customers' accounts as of liquidation. Since the securities were never sold, SIPC had only to deliver them.

SIPC alleges that FSSC pledged its customers' securities as collateral for loans to FSSC. In cases that have applied the pledge doctrine the pledgor owned the security. The pledge was a sufficient substitute for sale and purchase. Here, SIPC has alleged that the brokers pledged customers' stock. Thus the pledge doctrine cases are not directly on point.

The forced seller doctrine is probably SIPC's strongest basis for establishing its standing to assert Exchange Act claims. If the Exchange Act provides a remedy in those cases in which "a defendant is engaged in a scheme for the purpose of forcing the plaintiffs to convert their shares for money or other considerations," *Mosher*, 784 F.2d at 1389, arguably it should also provide a remedy where the defendants' scheme results in complete conversion of their shares. *See, e.g., Berner v. Lazzaro*, 730 F.2d 1319, 1322-23 (9th Cir.1984) (discussing purposes of private § 10(b) actions in connection with *in pari delicto* defense) *aff'd sub nom., Eichler v. Berner*, 472 U.S. 299, 105 S.Ct. 2622, 86 L.Ed.2d 215 (1985); *Alley v. Miramon*, 614 F.2d 1372, 1386-87 (5th Cir.1980) (approving application of Rule 10b-5 where defendant fraudulently obtained plaintiff's stock and liquidated the corporation). SIPC alleges that it has paid nearly $13 million, including costs and administrative expenses, to satisfy net equity claims. For every security that the brokers were supposed to be but were not holding for customers, the customers had claims for the value of the securities at time of liquidation. *See Rich*, 415 F.Supp. at 99-100.

For essentially the same reason that we rejected SIPC's "constructive purchase" theory, we reject its forced sales theory. The analysis proves too much. Were we to apply the forced seller doctrine to every instance in which SIPC liquidates a brokerage and satisfies customer

claims with cash, we would eliminate the purchase-or-sale requirement. Simple thefts and conversions would become forced sales merely because an insurer reimbursed the loss. The *Birnbaum* rule binds us. Until the Supreme Court repudiates it, we are unable to do so. *See Santa Fe Industries, Inc. v. Green*, 430 U.S. 462, 477-80, 97 S.Ct. 1292, 1302-04, 51 L.Ed.2d 480 (1977).

3. *Valid Claims*

Even though we hold that SIPC has shown, under the established exceptions to the *Birnbaum* rule, no set of facts under which it would be entitled to Exchange Act relief, we are unconvinced that no set of facts could be proven that would entitle it to Exchange Act relief. There are many reasons why the securities that FSSC and Sebag were supposed to be holding could be missing. "[S]ecurities belonging to customers may have been lost, improperly hypothecated, misappropriated, never purchased or even stolen. . . ." S.Rep. No. 95-763, *reprinted in* 1978 U.S. Code Cong. & Ad.News 764, 765. Most of these reasons would not satisfy the purchase-or-sale requirement of *Blue Chip Stamps*.

[9] SIPC has alleged, however, that the defendants made unauthorized transactions in customers' accounts as part of their fraudulent scheme. If so, some of those transactions could satisfy the *Birnbaum* rule. Where a broker abuses his customer's trust through unauthorized transactions, there is no reason why the *Birnbaum* rule should not be applied flexibly. We hold that when a broker makes an unauthorized purchase or sale of securities with his customer's assets, that purchase or sale may be attributed to the customer for purposes of satisfying the *Birn-*

baum rule.[2] *See Smoky Greenhaw Cotton Co. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 785 F.2d 1274, 1277 (5th Cir.1986) (unauthorized commodity trades). Allowing an Exchange Act claim for such a transaction implicates none of the concerns before the Court in *Blue Chip Stamps*. *See* 421 U.S. at 737-49, 95 S.Ct. at 1926-31.

[10] Under our holding, the district court erred in dismissing SIPC's Exchange Act claims. Our conclusion applies to SIPC, of course, only if it reimbursed a customer for the cash or securities the brokers were *supposed to be holding*, that is, the net equity of the customer's account before the unauthorized transactions. If the customer's reimbursement were based on the net equity of his or her account as though the transactions were authorized, that is, the net equity of the account after the unauthorized transactions, then the customer, not SIPC, has standing to assert the Exchange Act claim. In that case, SIPC would be relegated to more pedestrian theories, such as conversion, to recover on the claim to which it is subrogated.

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[2]Examples of unauthorized transactions in which the broker's purchase or sale should be attributed to the customer include:

1. Those in which a broker acting as a bailee of his customer's cash, *see Rich*, 415 F.Supp. at 99, uses the funds without authorization to purchase securities;

2. Those in which a broker acting as bailee of his customer's securities sells or pledges the securities without authorization.

In these cases, the purchase or sale made by the broker "passes through" to the customer for purposes of the *Birnbaum* rule. If on remand, however, SIPC can show no more than that the cash or securities are missing and cannot show that the broker engaged in an unauthorized transaction, no purchase or sale has been shown and recovery under section 10(b) or rule 10b-5 is inappropriate.

CONCLUSION

The district court did not err in dismissing SIPC's Exchange Act claims under a strict application of the *Birnbaum* rule. Nor did it err under any of the current doctrines ameliorating the harsh effect of the rule. We hold, however, that a broker's unauthorized purchase or sale of securities using a customer's assets may be attributed to the customer, and through the customer to SIPC, satisfying the purchase-or-sale requirement for an Exchange Act claim. Since a set of facts exists under which SIPC may be entitled to relief, we must allow SIPC an opportunity to prove those facts.

REVERSED and REMANDED.

SECURITIES INVESTOR PROTECTION CORPORATION, EUGENE W. BELL, TRUSTEE FOR THE LIQUIDATION OF JOSEPH SEBAG INCORPORATED, AND JOHN L. BRITTON, TRUSTEE FOR THE LIQUIDATION OF FIRST STATE SECURITIES CORPORATION,

Plaintiffs-Appellants,

v.

SEYMOUR VIGMAN, et al.,

Defendants,

and

EUGENE C. FERRI, JR., AND MOBILE INTERNATIONAL CORPORATION,

Defendants-Appellees.

Nos. 84-6074, 84-6311.

United States Court of Appeals,
Ninth Circuit.

Argued and Submitted March 8, 1985.

Decided July 2, 1985.

In a securities fraud action, plaintiffs appealed from an order of the United States District Court for the Central District of California, A. Wallace Tashima, J., dismissing four of the 75 defendants on the ground that the court lacked personal jurisdiction and that venue was improper. The Court of Appeals, Barnes, Senior Circuit Judge, held that: (1) section 27 of the Securities Exchange Act authorizes nationwide service of process; (2) so long as a defendant has minimum contacts with the United States, section 27 confers personal jurisdiction over the defendant in any federal district court, and the court in the instant case clearly had personal jurisdiction over the

individual appellee, a United States resident; (3) whether section 27 confers personal jurisdiction over a nonresident defendant depends on whether the defendant has acted within any district of the United States or sufficiently caused foreseeable consequences in this country; and (4) the coconspirator venue theory should be applied to determine venue in an action brought for violations under the Securities Exchange Act where there are numerous defendants, and where there is more than one appropriate forum in which to bring the action.

Reversed and remanded.

1. Federal Courts — 776

Court of Appeals, which reviews de novo the dismissal of a complaint without leave to amend, must determine whether the district court erred as a matter of law.

2. Courts — 489(1)

Jurisdiction to consider claims brought under the Securities Exchange Act of 1934 is vested exclusively in the federal courts. Securities Exchange Act of 1934, § 27, 15 U.S.C.A. § 78aa.

3. Securities Regulation — 139

When considering a Section 10(b) and Rule 10b-5 claim for relief, the court should liberally construe that claim in order to effectuate the policies underlying the federal securities laws. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b).

4. Federal Courts — 3, 71

"Jurisdiction" is the power to adjudicate, while "venue," which relates to the place where judicial author-

ity may be exercised, is intended for the convenience of the litigants.

See publication Words and Phrases for other judicial constructions and definitions.

5. Federal Courts — 71

In order for the district court to hear a case, the court must have not only personal jurisdiction over the parties, but also venue.

6. Federal Courts — 161

General jurisdictional statute which confers the power of the district court to hear a cause arising from a violation of a federal law or statute is the federal question statute. 28 U.S.C.A. § 1331.

7. Federal Courts — 192

A claim based on violation of a federal statute is a claim arising under federal law within the meaning of the federal question statute. 28 U.S.C.A. § 1331.

8. Securities Regulation — 135

Section 27 of the Securities Exchange Act authorizes nationwide service of process. Securities Exchange Act of 1934, § 27, 15 U.S.C.A. § 78aa.

9. Constitutional Law — 305(5)

When a federal district court is not sitting in diversity, due process requires that defendant have some "contacts, ties or relations" with the forum state in order to confer, in the district court, personal jurisdiction over defendant; nonetheless, "minimum contacts" with a particular district or state for purposes of personal jurisdiction is not a

limitation imposed on the federal courts in a federal question case by due process concerns. U.S.C.A. Const. Amends. 5, 14.

10. Securities Regulation — 135

Where a federal statute such as section 27 of the Securities Exchange Act confers nationwide service of process, the question becomes whether the party has sufficient contacts with the United States, not any particular state. Securities Exchange Act of 1934, § 27, 15 U.S.C.A. § 78aa.

11. Securities Regulation — 133

So long as a defendant has minimum contacts with the United States, section 27 of the Securities Exchange Act confers personal jurisdiction over the defendant in any federal district court, and the district court in the instant case clearly had personal jurisdiction over individual defendant, a United States resident. Securities Exchange Act of 1934, § 27, 15 U.S.C.A. § 78aa.

12. Securities Regulation — 133

Whether section 27 of the Securities Exchange Act confers personal jurisdiction over a nonresident defendant depends on whether the defendant has acted within any district of the United States or sufficiently caused foreseeable consequences in this country. Securities Exchange Act of 1934, § 27, 15 U.S.C.A. § 78aa.

13. Securities Regulation — 133

Intent of the venue and jurisdiction provisions of the securities laws is to grant potential plaintiffs liberal choice in their selection of a forum, and unless the balance of factors is strongly in favor of defendants,

plaintiff's choice of forum should rarely be disturbed. Securities Exchange Act of 1934, § 27, 15 U.S.C.A § 78aa.

14. Securities Regulation — 133

Coconspirator venue theory — which provides that where venue is established in a district for any defendant in a securities action which is brought against multiple defendants alleging a common scheme, then venue is proper as to all defendants even though certain defendants did not commit an act within the district — should be applied to determine venue in an action brought for violations under the Securities Exchange Act where there are numerous defendants, and where there is more than one appropriate forum in which to bring the action. Securities Exchange Act of 1934, § 27, 15 U.S.C.A. § 78aa.

15. Federal Civil Procedure — 201

There is an important interest to be served by joining all defendants in one action, thereby avoiding duplicitous litigation and inconsistent results.

16. Securities Regulation — 133

Under the "co-conspirator venue theory," where an action is brought against multiple defendants alleging a common scheme of acts or transactions in violation of securities statutes, so long as venue is established for any of the defendants in the forum district, venue is proper as to all defendants; and this is true even in the absence of any contact by some of the defendants in the forum district.

See publication Words and Phrases for other judicial constructions and definitions.

17. Securities Regulation — 133

The strong policy favoring litigation of related claims in the same forum supports application of a coconspirator venue theory in actions based upon violations of federal securities statutes.

18. Securities Regulation — 133

Inconvenience of requiring one defendant in a multidefendant federal securities action to litigate in a distant forum is greatly outweighed by the interests of judicial economy and bringing together in one lawsuit all related claims and alternative theories.

19. Federal Courts — 14

Determination of whether to exercise jurisdiction over pendent state claims is within the discretion of the district court, which is not required to exercise such jurisdiction.

Stephen C. Taylor, Sheppard, Mullin, Richter & Hampton, Los Angeles, Cal., for plaintiffs-appellants.

Daniel L. Goelzer, Gen. Counsel, Paul Gonson, Sol., Jacob H. Stillman, Asso. Gen. Counsel, Robert Mills, Sp. Counsel, SEC, Washington, D.C., amicus curiae.

Bill E. Schroeder, Patrick J. Steele, McCutchen, Black, Verleger & Shea, Los Angeles, Cal., for defendants-appellees.

Appeal from the United States District Court for the Central District of California.

Before BARNES, Senior Circuit Judge, REINHARDT, Circuit Judge, and GILLIAM, District Judge.*

BARNES, Senior Circuit Judge:

Appellants, Securities Investor Protection Corporation ("SIPC"), Eugene W. Bell and John L. Britton appeal the dismissal of four of seventy-five defendants from the securities fraud action brought in the United States District Court for the Central District of California. The district court dismissed these defendants, finding that it lacked personal jurisdiction over them, and that venue was improper in the Central District. This appeal presents questions of first impression in this Circuit, and we reverse the district court's dismissal of the defendants.

I. BACKGROUND

Appellant SIPC was established pursuant to the Securities Investors Protection Act of 1970, as amended, 15 U.S.C. § 78aaa, *et seq.*, in response to the collapse of numerous brokerage houses, in order to provide greater protection for customers of registered brokers and dealers and members of national securities exchanges. H.R.Rep. No. 1613, 91st Cong.2d Sess., *reprinted in* 1970 U.S.Code Cong. & Ad.News, 5254, 5254-55. Congress created the SIPC as a private, nonprofit corporation, whose members would consist of most of the broker-dealers registered under the Act. 1970 U.S.Code Cong. & Ad.News at 5258.

The SIPC has the power to sue and be sued, and to complain and defend in its corporate name and through

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* The Honorable Earl B. Gilliam, United States District Judge for the Southern District of California, sitting by designation.

its own counsel, in any State, Federal or other court. 15 U.S.C. § 78ccc(b)(1). In addition, the statute empowers the SIPC to seek a protective decree from a court of competent jurisdiction when one of the broker-dealer members has failed or is in danger of failing to meet its obligations to customers, and to appoint a trustee for the liquidation of the business of the broker-dealer member. *See* 15 U.S.C. § 78eee.

Upon application of the SIPC, on July 24, 1981, John L. Britton ("Britton") was appointed trustee for the liquidation of First State Securities Corporation ("FSSC"), a Delaware corporation with its principal place of business in North Miami, Florida. On July 27, 1981, Eugene W. Bell ("Bell") was appointed trustee for the liquidation of Joseph Sebag Incorporated ("Sebag"), a Delaware securities broker-dealer corporation, registered and licensed by the National Association of Securities Dealers, with its principal place of business in Los Angeles, California. These appointments were made pursuant to the provisions of 15 U.S.C. § 78eee.

This action was filed in the United States District Court for the Central District of California on July 22, 1983 by Appellants SIPC, Bell and Britton under the powers granted by 15 U.S.C. § 78ccc(b)(1). The complaint alleged securities fraud in violation of Section 10(b) of the Securities Exchange Act of 1934 ("Act") and Rule 10b-5 thereunder; a conspiracy under the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. § 1961, *et seq.* ("RICO"); common law fraud; and breach of fiduciary duty. Appellants alleged in their complaint that the seventy-five defendants engaged in acts which appellants contend to be predatory manipulative schemes practiced upon member broker-dealers of the SIPC and the investing public concerning the stock of

seven companies traded in the over-the-counter market, and that defendants engaged Sebag and FSSC as vehicles in furtherance of their scheme.

All seventy-five defendants in this action have moved the district court to dismiss and/or strike the complaint, basing their motions on various grounds. The district court entered an order dismissing certain of the seventy-five defendants on May 30, 1984, finding that it lacked personal jurisdiction over those defendants and that venue was improper in the Central District of California. On August 20, 1984, the district court amended the order, and dismissed without leave to amend but not on the merits, the complaint as to four of the defendants who are the appellees in this appeal. The claims against appellees were limited to alleged violations of the Act and common law fraud, and did not include any alleged violations under RICO or for breach of fiduciary duty.

Only two of the appellees remain in this appeal: Eugene C. Ferri, Jr. ("Ferri"), a United States citizen, and Mobile International Corporation ("Mobile"), a foreign corporation. The other two appellees, Leo Vela and Harry Drooker were dismissed by orders of this Court, pursuant to stipulations of the parties.

In dismissing the appellees, the district court rejected appellants' argument that Section 27 of the Act (15 U.S.C. § 78aa) allows nationwide service of process and confers personal jurisdiction over the defendants. It also refused to apply a co-conspirator theory of venue. The co-conspirator theory of venue provides that where venue is established in a district for any defendant in a securities action which is brought against multiple defendants alleging a common scheme, then venue is proper as to all defendants even though certain defendants did not commit an act within the district. *See generally,*

Securities and Exchange Commission v. Diversified Industries, 465 F.Supp. 104, 111 (D.D.C.1979) the court certified the May 30, 1984 order and the August 20, 1984 amended order for immediate appeal pursuant to Federal Rules of Civil Procedure 54(b), and appellants filed a timely notice of appeal.

II. ANALYSIS

There are two issues to be resolved by this court:

(1) Whether the district court erred in finding that it lacked personal jurisdiction over certain defendants in an action brought under the Securities Exchange Act of 1934; and

(2) Whether the district court erred when it failed to apply a co-conspirator venue theory to an action under the Securities Exchange Act of 1934.

A. Standard of Review

[1] This Court reviews de novo the dismissal of a complaint without leave to amend. *Whittington v. Whittington,* 733 F.2d 620, 621 (9th Cir.1984). We must determine whether the district court erred as a matter of law. *See e.g., Des Brisay v. Goldenfield Corp.,* 549 F.2d 133, 134 (9th Cir.1977); *Fitzsimmons v. Barton,* 589 F.2d 330, 331 (7th Cir.1979); *Mariash v. Morrill,* 496 F.2d 1138, 1140 (2d Cir.1974).

B. The Act

[2] Section 27 of the Securities Exchange Act of 1934 (15 U.S.C. § 78aa), grants jurisdiction to the federal courts and provides for venue and service of process. *Touche Ross & Co. v. Redington,* 442 U.S. 560, 577, 99 S.Ct. 2479, 2489, 61 L.Ed.2d 82 (1979). The jurisdiction to

consider claims brought under the Act is vested exclusively in the federal courts. *Clark v. Watchie,* 513 F.2d 994, 997 (9th Cir.), *cert. denied,* 423 U.S. 841, 96 S.Ct. 72, 46 L.Ed.2d 60 (1975).

Appellants argue that (1) Section 27 of the Act (15 U.S.C. § 78aa) provides for nationwide service of process, thereby conferring personal jurisdiction over defendants Ferri and Mobile, and (2) the district court applied a narrower standard for determining venue than that allowed under the Act, and it should have adopted a co-conspirator theory of venue. We agree.

[3] When considering a Section 10(b) and Rule 10b-5 claim for relief, the court should liberally construe that claim in order to effectuate the policies underlying the federal securities laws. *See, e.g., Affiliated Ute Citizens v. United States,* 406 U.S. 128, 150-54, 92 S.Ct. 1456, 1470-72, 31 L.Ed.2d 741 (1972); *Superintendent of Insurance v. Bankers Life and Casualty Co.,* 404 U.S. 6, 92 S.Ct. 165, 30 L.Ed.2d 128 (1971); *Mansbach v. Prescott, Ball and Turben,* 598 F.2d 1017, 1924-25 (6th Cir.1979).

[4, 5] In distinguishing between the principles of jurisdiction and venue, we note that "[j]urisdiction is the *power* to adjudicate, while venue, which relates to the place where judicial authority may be exercised, is intended for the *convenience* of the litigants." *Still v. Rossville Crushed Stone Co.,* 370 F.2d 324, 325 (6th Cir.1966) (per curiam) (emphasis added) (*citing Neirbo Co. v. Bethlehem Shipbuilding Corp.,* 308 U.S. 165, 60 S.Ct. 153, 84 L.Ed. 167 (1939); 1 Barron & Holtzoff, Federal Practice and Procedure (Wright Ed.), § 71), *cert. denied,* 387 U.S. 918, 87 S.Ct. 2030, 18 L.Ed.2d 970 (1967). In order for the district court to hear a case, the court must have not only personal jurisdiction over the parties, but also venue.

C. Personal Jurisdiction

In order to find personal jurisdiction over Appellees Ferri and Mobile in the Central District of California, there must be an applicable rule or statute which potentially confers jurisdiction over the defendants. *See, Amba Marketing Systems, Inc. v. Jobar International, Inc.,* 551 F.2d 784, 787 (9th Cir.1977). In addition, assertion of such jurisdiction must accord with constitutional principles of due process. *Id.* at 787.

[6, 7] The general jurisdictional statute which confers the power of the district court to hear a cause arising from a violation of a federal law or statute is 28 U.S.C. § 1331 (federal question). "A claim based on a violation of a federal statute is a claim arising under federal law within the meaning of 28 U.S.C. § 1331." *Haas v. Wieboldt Stores, Inc.,* 725 F.2d 71, 73 (7th Cir.1984). More specifically, Section 27 of the Act (15 U.S.C. § 78aa) confers federal jurisdiction over claims of violations of federal securities law. *Id.* at 73. *See also, Hilgeman v. National Insurance Co. of America,* 547 F.2d 298, 301 (5th Cir.1977); *Mariash v. Morrill,* 496 F.2d at 1142; *accord, GRM v. Equine Investment and Management,* 596 F.Supp. 307, 311 (S.D. Tex.1984); *Clement v. Pehar,* 575 F.Supp. 436, 438 (N.D.Ga.1983). Section 27 provides that any suit or action to enforce any liability or duty created under the Act may be brought in the district where any act or transaction constituting the violation occurred, and process may be served in any district where the defendant is an inhabitant or wherever the defendant may be found.[1]

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[1]15 U.S.C. § 78aa. *Jurisdiction of Offenses and Suits.*

The district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have exclusive jurisdiction of violations in

In addition, Rule 4(f), Federal Rules of Civil Procedure, sets the territorial limits within which service of process will be effective upon a party.[2] This rule limits the district court's ability to obtain personal jurisdiction over a defendant to jurisdiction in the state within which the district court sits, unless a statute of the United States confers territorial limits beyond the boundaries of that state.

In view of the foregoing, we find that there are rules and statutory authority which support nationwide service under the Act and confer personal jurisdiction in the Central District of California.

Appellees Ferri and Mobile argue that *Leroy v. Great Western United Corp.*, 443 U.S. 173, 99 S.Ct. 2710, 61 L.Ed.2d 464 (1979) controls. We disagree. In *Leroy,* the Court reversed the normal order of considering personal

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this chapter or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this chapter or rules and regulations thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. Any suit or action to enforce any liability or duty created by this chapter or rules and regulations thereunder, may be brought in any such district or in the district wherein the defendant is found or is an inhabitant or transacts business, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 1254, 1291, and 1292 of Title 28. No costs shall be assessed for or against it in the Supreme Court or other such courts.

[2]Fed.R.Civ.P. 4(f): *Territorial Limits of Effective Service.*

All Process other than a subpoena may be served anywhere within the territorial limits of the state in which the district court is held, and when authorization by statute of the United States or by these rules, beyond the territorial limits of that state . . .

jurisdiction in advance of venue, and found venue to be improper under Section 27 of the Act. However, the Court based its finding of lack of venue on the fact that Section 28(a) of the Act (15 U.S.C. § 78bb(a)) imposed no duty upon out-of-state officials to defined an action in a distant forum. *See Leroy,* 443 U.S. at 181-187, 99 S.Ct. at 2718. The Court went on to hold "§ 27 of the 1934 Act does not provide a basis for personal jurisdiction." *Id.* at 180, 99 S.Ct. at 2715.

The facts in *Leroy* are clearly distinguishable from the facts here. In *Leroy,* Great Western, whose principal place of business was in Texas, announced its intent to make a tender offer for a corporation with its principal place of business and most of its assets located in Idaho. Great Western filed an action in the federal district court in Texas, seeking to invalidate the Idaho takeover statutes as they purported to apply to interstate cash tender offers to purchase securities traded on the national exchange. The defendants in *Leroy* were Idaho state officials, and the Court based its finding of improper venue and lack of personal jurisdiction on Section 28(a) of the Act. The Court stated that "[t]here is nothing in its text or its legislative history to suggest that it imposes any *duty on the States* or that indicates who might enforce any such duty. [Section 28(a)] was plainly *intended to protect, rather to limit, state authority." Id.* at 182, 99 S.Ct. at 2716. (emphasis added).

The defendants in the case before us are private parties and not state officials. Furthermore, the appellants are not challenging the validity of a state statute. SIPC, Bell and Britton brought this action alleging that the private defendants' actions constituted violations of federal securities laws. Because the Court in *Leroy* based its finding of lack of personal jurisdiction on the fact that venue was

improper, the Court's holding with respect to personal jurisdiction does not apply here. "It is simply too late in the day to argue that Section 27 does not authorize nationwide service of process on any individual named in the complaint, provided, of course, the complaint states a claim under the 1934 Act." *Mariash v. Morrill,* 496 F.2d at 1142.

[8] We are persuaded by the holdings of the Second Circuit in *Mariash* and the Seventh Circuit in *Fitzsimmons v. Barton,* 589 F.2d 330 (7th Cir.1979), that Section 27 of the Act (15 U.S.C. § 78aa) authorizes nationwide service of process. However, we must now determine whether this statute, which confers jursidiction over the defendants, accords with constitutional principles of due process. *See Amba Marketing Systems, Inc.,* 551 F.2d at 787.

We address briefly the due process considerations inherent in personal jurisdiction. The Supreme Court in *International Shoe Co. v. Washington,* 326 U.S. 310, 66 S.Ct. 154, 90 L.Ed. 95 (1945), set forth the "minimum contacts" doctrine to be applied in determining whether due process will be afforded to defendants where a court asserts *in personam* jurisdiction over them. *See Id.* at 316, 66 S.Ct. at 158. *International Shoe* and its progeny, *Hanson v. Denckla,* 357 U.S. 235, 78 S.Ct. 1228, 2 L.Ed.2d 1283 (1958); *Shaffer v. Heitner,* 433 U.S. 186, 97 S.Ct. 2569, 53 L.Ed.2d 683 (1977); and more recently *Worldwide Volkswagen Corp. v. Woodson,* 444 U.S. 286, 100 S.Ct. 559, 62 L.Ed.2d 490 (1980), have required some "contacts, ties or relations" with the forum state in order to confer *in personam* jurisdiction over a defendant. *See Worldwide Volkswagon,* 444 U.S. at 299, 100 S. Ct. at 568.

[9] We note that the line of cases flowing from *International Shoe* deals with a state court's jurisdiction over a non-resident defendant, generally by the use of a state

long-arm statute. When a federal district court is sitting in diversity, we agree that due process requires that the defendant have some "contacts, ties or relations" with the forum state in order to confer, in the district court, personal jurisdiction over the defendant. Nonetheless,

> 'minimum contacts' with a particular district or state for purposes of personal jurisidiction is *not* a limitation imposed on the federal courts in a federal question case by due process concerns. The Constitution does not require the federal distrcts to follow state boundaries .... It is clear that Congress can provide for nationwide service of process in federal court for federal question cases without falling short of the requirements of due process.

Johnson v. Creative Arts & Wool Masters, Inc., 743 F.2d 947, 950 (1st Cir.1984) (citations and footnotes omitted).

[10] Where a federal statute such as Section 27 of the Act confers nationwide service of process, "the question becomes whether the party has sufficient contacts with the United States, not any particular state." *Nelson v. Quimby Island Reclamation District,* 491 F.Supp. 1364, 1378 (N.D.Cal.1980). *See also, FTC v. Jim Walter Corp.,* 651 F.2d 251, 256 (5th Cir.1981) (due process requires only that a defendant in a federal suit have minimum contacts with the United States, the sovereign that created the court); *Fitzsimmons v. Barton,* 589 F.2d at 333 (the defendant, a resident citizen of the United States, had sufficient contacts with the United States to support the fairness of exercise of jurisdiction over him by a United States court); *Mariash v. Morrill,* 496 F.2d at 1143 (where the defendants reside within the territorial boundaries of the United States, the "minimum contacts," required to justify the federal government's exercise of power over them, are present).

[11] We hold, therefore, that so long as a defendant has minimum contacts with the United States, Section 27 of the Act confers personal jurisdiction over the defendant in any federal district court. The district court erred in finding that it lacked personal jurisdiction over Ferri, a United States citizen.

Nevertheless, in *Travis v. Anthes Imperial Ltd.*, 473 F.2d 515 (9th Cir.1974), this Court held that Congress intended Section 27 to " 'authorize service on a defendant who can be "found" only in a foreign country . . .' " *Id.* at 529 (quoting *Leasco Data Processing Equipment Corp. v. Kerman*, 468 F.2d 1326, 1340 (2d Cir.1974)). The Court subsequently concluded that " 'although the section does not specifically deal with *in personam* jurisdiction, it is reasonable to infer that Congress meant to assert personal jurisdiction over foreigners not present in the United States to but, of course, not beyond the bounds permitted by the due process clause of the Fifth Amendment . . . .' " *Travis*, 473 F.2d at 529 (quoting *Leasco*, 468 F.2d at 1340). The *Travis* court concluded that when service of process had been made outside of the United States, personal jurisdiction could be acquired over "defendants who have acted within the district or sufficiently caused foreseeable consequences there, . . ." *Id.* at 529.

[12] Having concluded that Section 27 authorizes nationwide service of process, and that personal jurisdiction in any district is therefore conferred over resident defendants upon a showing of minimum contacts with the United States, we conclude that due process demands imposition of a similar rule with respect to foreign defendants. Thus, whether Section 27 will confer personal jurisdiction over a non-resident defendant depends on whether the defendant has acted within any district of the United States or sufficiently caused forseeable consequences in this country. *Cf. Travis, supra.*[3] We remand this question in order that the district court may make a determination as to whether the consequences of Mobile's acts within the United States were reasonably forseeable to confer personal jurisdiction over Mobile.

D. Venue

The venue issue is also governed by Section 27 of the Act (15 U.S.C. § 78aa). *Hilgeman v. National Insurance Co. of America*, 547 F.2d at 301. Under Section 27 of the Act, a suit to enforce any liability or duty created under the Act may be brought either (1) in the district wherein the defendant is found or is an inhabitant or transacts business, or (2) in the district wherein any act or transaction constituting the violation occurred. *See* note 2, *supra; see also, Mariash v. Morrill*, 496 F.2d at 1144; *GRM v. Equine Investment and Management Group*, 596 F.Supp. at 311; *Carty v. Health-Chem Corp.*, 567 F.Supp. 1, 2 (E.D.Pa.1982).

Since neither Ferri nor Mobile is found within the Central District of California, and its does not appear

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[3] The district court properly quashed service on Mobile. The court properly applied state procedural law in determining the proper method for service of process pursuant to Federal Rules of Civil Procedure 4(c)(2)(C). Under California Code of Civil Procedure § 416.20, a complaint must be served upon a person who is a trustee of a dissolved corporation and its stockholders. Although California Corporations Code § 2011 allows officers, directors and shareholders to be served, California courts have concluded that the Corporations Code "does not apply to foreign corporations which have dissolved." *North American Asbestos Corp. v. Superior Court*, 128 Cal.App.3d 138, 144, 179 Cal.Rptr. 889 (1982). Nonetheless, under Section 27 of the Act, if the district court finds that Mobile's acts were sufficient to confer personal jurisdiction, appellents should be allowed to perfect service of process.

from the record that they transact, or have ever transacted, business within the Central District, we need to determine whether venue is proper based upon whether any act or transaction constituting a violation occurred in the Central District.

[13] It does not appear from the briefs filed in this case, or from the record below, that Appellees Ferri or Mobile had any actual contacts with the forum (the Central District of California) or that they performed any acts within the forum in violation of the Act. However, "[t]he 'act' contemplated by the statute need not be crucial, nor must 'the fraudulent scheme be hatched in the forum district.'" *Hilgeman v. National Insurance Co. of America*, 547 F.2d at 301 (quoting *Hooper v. Mountain State Securities Corp.*, 282 F.2d 195, 204 (5th Cir.1960)). "Without question, the intent of the venue and jurisdiction provisions of the securities laws is to grant potential plaintiffs liberal choice in their selection of a forum." *Ritter v. Zuspan*, 451 F.Supp. 926, 928 (E.D.Mich.1978), and unless the balance of factors is strongly in favor of the defendants, the plaintiff's choice of forum should rarely be disturbed. *Gulf Oil Corp. v. Gilbert*, 330 U.S. 501, 508, 67 S.Ct. 839, 843, 91 L.Ed. 1055 (1947).

[14, 15] Appellants argue that a co-conspirator venue theory should be applied to determine venue in an action brought for violations under the Act in which there are numerous defendants, and where there is more than one appropriate forum in which to bring the action. We agree, and note that the Supreme Court has stated in dictum, "that in the unusual case in which it is not clear that the claim arose in only one specific district, a plaintiff may choose between those two (or conceivably even more) districts that with approximately equal plausibility ... may be assigned as the locus of the claim." *Leroy v. Great Western United Corp.*, 443 U.S. at 185, 99 S.Ct. at 2717. (citation omitted). In this case, since the defendants are generally located in either California or Florida, and the securities broker-dealer corporations engaged by the defendants in furtherance of their scheme, Sebag and FSSC, had their principal places of business in California and Florida, respectively, this action could have been maintained with "approximately equal plausibility" in either state. There is an important interest to be served by joining all defendants in one action, thereby avoiding duplicitous litigation and inconsistent results. *Wyndham Associates v. Bintliff*, 398 F.2d 614, 619 (2d Cir.), *cert. denied*, 393 U.S. 977, 89 S.Ct. 444, 21 L.Ed.2d 438 (1968).

[16] Under the co-conspirator venue theory, where an action is brought against multiple defendants alleging a common scheme of acts or transactions in violation of securities statutes, so long as venue is established for any of the defendants in the forum district, venue is proper as to all defendants. This is true even in the absence of any contact by some of the defendants in the forum district. Wright, Miller & Cooper, Federal Practice and Procedure: Jurisdiction § 3824 (1986).

[17] The co-conspirator venue theory has been adopted by the Second and Fifth Circuits as applied to multi-defendant litigation alleging violations of the federal securities statutes.[4] In addition, this venue theory has been widely adopted by the federal district courts in securities litigation.[5] We agree with these courts. The

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[4] *Wyndham Associates v. Bintliff*, 398 F.2d 614 (2d Cir.), *cert. denied*, 393 U.S. 977, 89 S.Ct. 444, 21 L.Ed.2d 438 (1968); *Hilgeman v. National Insurance Co. of America*, 547 F.2d 298 (5th Cir.1977).

[5] *See e.g., Stewart v. Fry*, 575 F.Supp. 753 (E.D. Mo.1983); *DeMoss v. First Artists Production Co., Ltd.*, 571 F.Supp. 409 (N.D.Ohio

strong policy favoring the litigation of related claims in the same forum supports the application of a co-conspirator venue theory in actions based upon violations of federal securities statutes.

[18] We recognize that in adopting the co-conspirator venue theory in this Circuit, "it is inevitable that some party will be inconvenienced no matter where the suit is tried." *Wyndham Associates v. Bintliff,* 398 F.2d at 620-621. However, the invonvenience of requiring one defendant in a multi-defendant action to litigate in a distant forum is greatly outweighed by the interest of judicial economy and bringing together in one lawsuit, all related claims and alternative theories.

Ferri and Mobile claim that even assuming a co-conspirator venue theory apples to a securities action, appellants have not alleged sufficient facts to connect them to the alleged conspiracy, and therefore venue is not proper. We agree that a plaintiff's complaint must set out more than mere bald allegations of a claim. However, "a complaint need only set out a generalized statement of facts from which [a] defendant will be able to frame a responsive pleading." Wright & Miller, Federal Practice and Procedure: Civil § 1357 (1969); *See also, Kadar Corp. v. Milbury,* 549 F.2d 230, 233 (1st Cir.1977).

1983); *Hill v. Turner,* 492 F.Supp. 61 (M.D.Pa.1980); *Securities and Exchange Commission v. Diversified Industries, Inc.,* 465 F.Supp. 104 (D.D.C.1979); *Warren v. Bokum Resources Corp.,* 433 F.Supp. 1360 (D.N.M.1977); *Berlozzi v. King Louie International, Inc.,* 420 F.Supp. 1166 (D.R.I.1976); *Arpel v. Homas,* 390 F.Supp. 908 (W.D.Pa.1975); *Securities and Exchange Commission v. National Student Marketing Corp.,* 360 F.Supp. 284 (D.D.C.1973); *Levin v. Great Western Sugar Co.,* 274 F.Supp. 974 (D.N.J.1967); *Zorn v. Anderson,* 263 F.Supp. 745 (S.D.N.Y.1966).

The appellants have alleged that Ferri maintained securities accounts at FSSC and that Mobile maintained a securities accout at A.G. Becker, incorporated through FSSC. Although we question whether these facts are sufficient to connect Appellees Ferri and Mobile with the alleged scheme engaged in by the other defendants, and which appellants allege to be in violation of federal securities law, we are mindful of the liberal pleading amendment provisions of the Federal Rules of Civil Procedure. *See* Fed.R.Civ.P. 15(a) (leave to amend shall be freely given when justice so requires). Thus, upon remand, the district court should allow appellants to amend their pleadings to show the nexus between these two defendants and the scheme in which the other defendants are involved.

E. Pendent State Claims

In addition to violations of the Act, appellants asserted a claim for common law fraud against Appellees Ferri and Mobile. This pendent state claim was dismissed when the district court dismissed the entire complaint without leave to amend as to Appellees Ferri and Mobile.

[19] The determination of whether to exercise jurisdiction over pendent state claims is within the discretion of the disctrict court, and the district court is not required to exercise such jurisdiction. *United Mine Workers v. Gibbs,* 383 U.S. 715, 726, 86 S.Ct. 1130, 1139, 16 L.Ed.2d 218 (1966); *Kehr v. Smith Barney Harris Upham & Co.,* 736 F.2d 1283, 1287 (9th Cir.1984). Thus, on remand, we leave to the discretion of the district court whether the claim for common law fraud against Ferri and Mobile should be reinstated.

III. CONCLUSION

The appropriate standard to be applied in determining whether the district court has personal jurisdiction over defendants in an action brought under the Securities and Exchange Act of 1934, is whether that defendant had sufficient contacts with the United States and not whether the defendant had sufficient contacts with the forum district. The district court clearly had personal jurisdiction over Appellee Ferri, a United States resident. If the district court, on remand, finds that Appellee Mobile had sufficient contacts with the United States, and that its acts caused foreseeable consequences, then it would have personal jurisdiction over Mobile as well.

The district court erred in failing to adopt a co-conspirator venue theory in this action. Since we hold that such a theory applies to actions brought under the federal securities laws, the district court, on remand, should allow the appellants to amend their pleadings to demonstrate the relationship between these two defendants and the predatory manipulative scheme engaged in by the other defendants.

CHAPTER 96 — RACKETEER INFLUENCED AND CORRUPT ORGANIZATIONS ACT, 18 U.S.C.A. §§ 1961-68 (WEST. 1984)

§ 1961. Definitions

As used in this chapter —

(1) "racketeering activity" means (A) any act or threat involving murder, kidnaping, gambling, arson, robbery, bribery, extortion, or dealing in narcotic or other dangerous drugs, which is chargeable under State law and punishable by imprisonment for more than one year; (B) any act which is indictable under

any of the following provisions of title 18, United States Code: Section 201 (relating to bribery), section 224 (relating to sports bribery), sections 471, 472, and 473 (relating to counterfeiting), section 659 (relating to theft from interstate shipment) if the act indictable under section 659 is felonious, section 664 (relating to embezzlement from pension and welfare funds), sections 891-894 (relating to extortionate credit transactions), section 1084 (relating to the transmission of gambling information), section 1341 (relating to mail fraud), section 1343 (relating to wire fraud), section 1503 (relating to obstruction of justice), section 1510 (relating to obstruction of criminal investigations), section 1511 (relating to the obstruction of State or local law enforcement), section 1951 (relating to interference with commerce, robbery, or extortion), section 1952 (relating to racketeering), section 1953 (relating to interstate transportation of wagering paraphernalia), section 1954 (relating to unlawful welfare fund payments), section 1955 (relating to the prohibition of illegal gambling businesses), sections 2314 and 2315 (relating to interstate transportation of stolen property), sections 2341-2346 (relating to trafficking in contraband cigarettes), sections 2421-24 (relating to white slave traffic), (C) any act which is indictable under title 29, United States Code, section 186 (dealing with restrictions on payments and loans to labor organizations) or section 501(c) (relating to embezzlement from union funds), or (D) any offense involving fraud connected with a case under title 11, fraud in the sale of securities, or the felonious manufacture, importation, receiving, concealment, buying, selling, or otherwise dealing in narcotic or other dangerous

drugs, punishable under any law of the United States;

(2) "State" means any State of the United States, the District of Columbia, the Commonwealth of Puerto Rico, and territory or possession of the United States, any political subdivision, or any department, agency, or instrumentality thereof;

(3) "person" includes any individual or entity capable of holding a legal or beneficial interest in property;

(4) "enterprise" includes any individual, partnership, corporation, association, or other legal entity, and any union or group of individuals associated in fact although not a legal entity;

(5) "pattern of racketeering activity" requires at least two acts of racketeering activity, one of which occurred after the effective date of this chapter and the last of which occurred within ten years (excluding any period of imprisonment) after the commission of a prior act of racketeering activity;

(6) "unlawful debt" means a debt (A) incurred or contracted in gambling activity which was in violation of the law of the United States, a State or political subdivision thereof, or which is unenforceable under State or Federal law in whole or in part as to principal or interest because of the laws relating to usury, and (B) which was incurred in connection with the business of gambling in violation of the law of the United States, a State or political subdivision thereof, or the business of lending money or a thing of value at a rate usurious under State or Federal law, where the usurious rate is at least twice the enforceable rate;

(7) "racketeering investigator" means any attorney or investigator so designated by the Attorney General and charged with the duty of enforcing or carrying into effect this chapter;

(8) "racketeering investigation" means any inquiry conducted by any racketeering investigator for the purpose of ascertaining whether any person has been involved in any violation of this chapter or of any final order, judgment, or decree of any court of the United States, duly entered in any case or proceeding arising under this chapter;

(9) "documentary material" includes any book, paper, document, record, recording, or other material; and

(10) "Attorney General" includes the Attorney General of the United States, the Deputy Attorney General of the United States, any Assistant Attorney General of the United States, or any employee of the Department of Justice or any employee of any department or agency of the United States so designated by the Attorney General to carry out the powers conferred on the Attorney General by this chapter. Any department or agency so designated may use in investigations authorized by this chapter either the investigative provisions of this chapter or the investigative power of such department or agency otherwise conferred by law.

(Added Pub.L. 91–452, Title IX, § 901(a), Oct. 15, 1970, 84 Stat. 941, and amended Pub.L. 95–575, § 3(c), Nov. 2, 1978, 92 Stat. 2465; Pub.L. 95–598, Title III, § 314(g), Nov. 6, 1978, 92 Stat. 2677.)

§ 1962. Prohibited activities

(a) It shall be unlawful for any person who has received any income derived, directly or indirectly, from a pattern of racketeering activity or through collection of an unlawful debt in which such person has participated as a principal within the meaning of section 2, title 18, United States Code, to use or invest, directly or indirectly, any part of such income, or the proceeds of such income, in acquisition of any interest in, or the activities of which affect, interstate or foreign commerce. A purchase of securities on the open market for purposes of investment, and without the intention of controlling or participating in the control of the issuer, or of assisting another to do so, shall not be unlawful under this subsection if the securities of the issuer held by the purchaser, the members of his immediate family, and his or their accomplices in any pattern or racketeering activity or the collection of an unlawful debt after such purchase do not amount in the aggregate to one percent of the outstanding securities of any one class, and do not confer, either in law or in fact, the power to elect one or more directors of the issuer.

(b) It shall be unlawful for any person through a pattern of racketeering activity or through collection of an unlawful debt to acquire or maintain, directly or indirectly, any interest in or control of any enterprise which is engaged in, or the activities of which affect, interstate or foreign commerce.

(c) It shall be unlawful for any person employed by or associated with any enterprise engaged in, or the activities of which affect, interstate or foreign commerce, to conduct or participate, directly or indirectly, in the conduct of such enterprises's affairs through a pattern of racketeering activity or collection of unlawful debt.

(d) It shall be unlawful for any person to conspire to violate any of the provisions of subsections[1] (a), (b), or (c) of this section.

(Added Pub.L. 91-452, Title IX, § 901(a), Oct. 15, 1970, 84 Stat. 942.)

§ 1963. Criminal penalties

(a) Whoever violates any provision of section 1962 of this chapter shall be fined not more than $25,000 or imprisoned not more than twenty years, or both, and shall forfeit to the United States (1) any interest he has acquiried or maintained in violation of section 1962, and (2) any interest in, security of, claim agasinst, or property or contractual right of any kind affording a source of influence over, any enterprise which he has established, operated, controlled, conducted, or participated in the conduct of, in violation of section 1962.

(b) In any action brought by the United States under this section, the district courts of the United States shall have jurisdiction to enter such restraining orders or prohibitions, or to take such other actions, including, but not limited to, the acceptance of satisfactory performance bonds, in connection with any property or other interest subject to forfeiture under this section, as it shall deem proper.

(c) Upon conviction of a person under this section, the court shall authorize the Attorney General to seize all property or other interest declared forfeited under this section upon such terms and conditions as the court shall deem proper. If a property right or other interest is not exercisable or transferable for value by the United States,

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[1]So in original. Probably should be "subsection".

it shall expire, and shall not revert to the convicted person. All provisions of law relating to the disposition of property, or the proceeds from the sale thereof, or the remission or mitigation of forfeitures for violation of the customs laws, and the compromise of claims and the award of compensation to informers in respect of such forfeitures shall apply to forfeitures incurred, or alleged to have been incurred, under the provisions of this section, insofar as applicable and not inconsistent with the provisions hereof. Such duties as are imposed upon the collector of customs or any other person with respect to the disposition of property under the customs laws shall be performed under this chapter by the Attorney General. The United States shall dispose of all such property as soon as commercially feasible, making due provision for the rights of innocent persons.

(Added Pub.L. 91-452, Title IX, § 901(a), Oct. 15, 1970, 84 Stat. 943.)

§ 1964. Civil remedies

(a) The district courts of the United States shall have jurisdiction to prevent and restrain violations of section 1962 of this chapter by issuing appropriate orders, including, but not limited to: ordering any person to divest himself of any interest, direct or indirect, in any enterprise; imposing reasonable restrictions on the future activities or investments of any person, including, but not limited to, prohibiting any person from engaging in the same type of endeavor as the enterprise engaged in, the activities of which affect interstate or foreign commerce; or ordering dissolution or reorganization of any enterprise, making due provision for the rights of innocent persons.

(b) The Attorney General may institute proceedings under this section. In any action brought by the United States under this section, the court shall proceed as soon as practicable to the hearing and determination thereof. Pending final determination thereof, the court may at any time enter such restraining orders or prohibitions, or take such other actions, including the acceptance of satisfactory performance bonds, as it shall deem proper.

(c) Any person injured in his business or property by reason of a violation of section 1962 of this chapter may sue therefor in any appropriate United States district court and shall recover threefold the damages he sustains and the cost of the suit, including a reasonable attorney's fee.

(d) A final judgment or decree rendered in favor of the United States in any criminal proceeding brought by the United States under this chapter shall estop the defendant from denying the essential allegations of the criminal offense in any subsequent civil proceeding brought by the United States.

(Added Pub.L. 91-452, Title IX, § 901(a), Oct. 15, 1970, 84 Stat. 943.

§ 1965. Venue and process

(a) Any civil action or proceeding under this chapter against any person may be instituted in the district court of the United States for any district in which such person resides, is found, has an agent, or transacts his affairs.

(b) In any action under section 1964 of this chapter in any district court of the United States in which it is shown that the ends of justice require that other parties residing in any other district be brought before the court, the court may cause such parties to be summoned, and

process for that purpose may be served in any judicial district of the United States by the marshal thereof.

(c) In any civil or criminal action or proceeding instituted by the United States under this chapter in the district court of the United States for any judicial district, subpenas issued by such court to compel the attendance of witnesses may be served in any other judicial district, except that in any civil action or proceeding no such subpena shall be issued for service upon any individual who resides in another district at a place more than one hundred miles from the place at which such court is held without approval given by a judge of such court upon a showing of good cause.

(d) All other process in any action or proceeding under this chapter may by be served on any person in any judicial district in which such person resides, is found, has an agent, or transacts his affairs.

(Added Pub.L. 91-452, Title IX, § 901(a), Oct. 15, 1970, 84 Stat. 944.)

§ 1966. Expedition of actions

In any civil action instituted under this chapter by the United States in any district court of the United States, the Attorney General may file with the clerk of such court a certificate stating that in his opinion the case is of general public importance. A copy of that certificate shall be furnished immediately by such clerk to the chief judge or in his absence to the presiding district judge of the district in which such action is pending. Upon receipt of such copy, such judge shall designate immediately a judge of that district to hear and determine action. The judge so designated shall assign such action for hearing as soon as practicable, participate in the hearings and

determination thereof, and cause such action to be expedited in every way.

(Added Pub.L. 91-452, Title IX, § 901(a), Oct. 15, 1970, 84 Stat. 944.)

§ 1967. Evidence

In any proceeding ancillary to or in any civil action instituted by the United States under this chapter the proceedings may be open or closed to the public at the discretion of the court after consideration of the rights of affected persons.

(Added Pub.L. 91-452, Title IX, § 901(a), Oct. 15, 1970, 84 Stat. 944.)

§ 1968. Civil investigative demand

(a) Whenever the Attorney General has reason to believe that any person or enterprise may be in possession, custody, or control of any documentary materials relevant to a racketeering investigation, he may, prior to the institution of a civil or criminal proceeding thereon, issue in writing, and cause to be served upon such person, a civil investigative demand requiring such person to produce such material for examination.

(b) Each such demand shall —

(1) state the nature of the conduct constituting the alleged racketeering violation which is under investigation and the provision of law applicable thereto;

(2) describe the class or classes of documentary material produced thereunder with such definiteness and certainty as to permit such material to be fairly identified;

(3) state that the demand is returnable forthwith or prescribe a return date which will provide a reasonable period of time within which the material so demanded may be assembled and made available for inspection and copying or reproduction; and

(4) identify the custodian to whom such material shall be made available.

(c) No such demand shall —

(1) contain any requirement which would be held to be unreasonable if contained in a subpena duces tecum issued by a court of the United States in aid of a grand jury investigation of such alleged racketeering violation; or

(2) require the production of any documentary evidence which would be privileged from disclosure if demanded by a subpena duces tecum issued by a court of the United States in aid of a grand jury investigation of such alleged racketeering violation.

(d) Service of any such demand or any petition filed under this section may be made upon a person by —

(1) delivering a duly executed copy thereof to any partner, executive officer, managing agent, or general agent thereof, or to any agent thereof authorized by appointment or by law to receive service of process on behalf of such person, or upon any individual person;

(2) delivering a duly executed copy thereof to the principal office or place of business of the person to be served; or

(3) depositing such copy in the United States mail, by registered or certified mail duly addressed

to such person at its principal office or place of business.

SECURITIES EXCHANGE ACT OF 1934, 15 U.S.C.S. 78j (LAW CO-OP. 1983)

§ 78j. Manipulative and deceptive devices

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange —

(a) To effect a short sale, or to use or employ any stop-loss order in connection with the purchase or sale, or any security registered on a national securities exchange, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

(June 6, 1934, ch 404, Title I, § 10, 48 Stat. 891.)

SECURITIES AND EXCHANGE COMMISSION
RULE 10b-5, 17 CFR § 240.10b-5 (1989)

§ 240.10b-5 Employment of manipulative and deceptive devices.

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange.

(a) To employ any device, scheme, or artifice to defraud,

(b) To employ any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

(Sec. 10; 48 Stat. 891; 15 U.S.C. 78j)

[13 FR 8183, Dec. 22, 1948, as amended at 16 FR 7928, Aug. 11, 1951]

SECURITIES INVESTOR PROTECTION ACT OF 1970, 15 U.S.C.S. §§ 78aaa-78*lll* (LAW Co-op. 1983)

§ 78aaa. Short title

This Act, with the following table of contents, may be cited as the "Securities Investor Protection Act of 1970".

(Dec. 30, 1970, P. L. 91-598, § 1(a), 84 Stat. 1636.)

§ 78bbb. Application of Securities Exchange Act of 1934

Except as otherwise provided in this Act, the provisions of the Securities Exchange Act of 1934 (15 U.S.C. sec. 78a and fol.; hereinafter referred to as the "1934 Act") apply as if this Act constituted an amendment to, and was included as a section of, such Act.

(Dec. 30, 1970, P. L. 91-598, § 2, 84 Stat. 1637.)

§ 78ccc. Securities Investor Protection Corporation

(a) Creation and membership. (1) *Creation.* There is hereby established a body corporate to be known as the "Securities Investor Protection Corporation" (hereafter in this Act referred to as "SIPC"). SIPC shall be a nonprofit corporation and shall have succession until dissolved by Act of the Congress. SIPC shall—

(A) not be an agency or establishment of the United States Government; and

(B) except as otherwise provided in this Act, be subject to, and have all the powers conferred upon a nonprofit corporation by, the District of Columbia Nonprofit Corporation Act (D.C. Code, section 29-1001 and fol.).

(2) Membership. (A) Members of SIPC. SIPC shall be a membership corporation the members of which shall be all persons registered as brokers or dealers under section 15(b) of the 1934 Act [15 USCS § 78*o*(b)], other than—

(i) persons whose principal business, in the determination of SIPC, taking into account business of affiliated entities, is conducted outside the United States and its territories and possessions; and

(ii) persons whose business as a broker or dealer consists exclusively of (I) the distribution of shares of registered open end investment companies or unit investment trusts, (II) the sale of variable annuities, (III) the business of insurance, or (IV) the business of rendering investment advisory services to one or more registered investment companies or insurance company separate accounts.

(B) Commission review. SIPC shall file with the Commission a copy of any determination made pursuant to subparagraph (A)(i). Within thirty days after the date of such filing, or within such longer period as the Commission may designate of not more than ninety days after such date if it finds such longer period to be appropriate and publishes its reasons for so finding, the Commission shall, consistent with the public interest and the purposes of this Act, affirm, reverse, or amend any such determination of SIPC.

(C) Additional members. SIPC shall provide by rule that persons excluded from membership in SIPC under subparagraph (A)(i) may become members of SIPC under such conditions and upon such terms as SIPC shall require by rule, taking into account such matters as the availability of assets and the ability to conduct a liquidation if necessary.

(D) Disclosure. Any broker or dealer excluded from membership in SIPC under subparagraph (A)(i) shall, as required by the Commission by rule, make disclosures of its exclusion and other relevant information to the customers of such broker or dealer who are living in the United States or its territories and possessions.

(b) Powers. In addition to the powers granted to SIPC elsewhere in this Act, SIPC shall have the power —

(1) to sue and be sued, complain and defend, in its corporate name and through its counsel, in any State, Federal, or other court;

(2) to adopt, alter, and use a corporate seal, which shall be judicially noticed;

(3) to adopt, amend, and repeal, by its Board of Directors, such bylaws as may be necessary or appropriate to carry out the purposes of this Act, including bylaws relating to —

(A) the conduct of its business; and

(B) the indemnity of its directors, officers, and employees (including any such person acting as trustee or otherwise in connection with a liquidation proceeding) for liabilities and expenses actually and reasonably incurred by any such person in connection with the defense or settlement of an action or suit if such person acted in good faith and in a manner reasonably believed to be consistent with the purposes of this Act.[;]

(4) to adopt, amend, and repeal, by its Board of Directors, such rules as may be necessary or appropriate to carry out the purposes of this Act, including rules relating to —

(A) the definition of terms used in this Act, other than those terms for which a definition is provided in section 16 [15 USCS § 78*111*];

(B) the procedures for the liquidation of members and direct payment procedures, including the transfer of customer accounts, the distribution of

customer property, and the advance and payment of SIPC funds; and

(C) the exercise of all other rights and powers granted to it by this Act;

(5) to conduct its business (including the carrying on of operations and the maintenance of offices) and to exercise all other rights and powers granted to it by this Act in any State or other jurisdiction without regard to any qualification, licensing, or other statute in such State or other jurisdiction;

(6) to lease, purchase, accept gifts or donations of or otherwise acquire, to own, hold, improve, use, or otherwise deal in or with, and to sell, convey, mortgage, pledge, lease, exchange or otherwise dispose of, any property, real, personal or mixed, or any interest therein, wherever situated;

(7) Subject to the provisions of subsection (c), to elect or appoint such officers, attorneys, employees, and agents as may be required, to determine their qualifications, to define their duties, to fix their salaries, require bonds for them and fix the penalty thereof;

(8) to enter into contracts, to execute instruments, to incur liabilities, and to do any and all other acts and things as may be necessary or incidental to the conduct of its business and the exercise of all other rights and powers granted to SIPC by this Act; and

(9) by bylaw, to establish its fiscal year.

(c) Board of Directors. (1) *Functions.* SIPC shall have a Board of Directors, which, subject to the provisions of this Act, shall determine the policies which shall govern the operations of SIPC.

(2) *Number and appointment.* The Board of Directors shall consist of seven persons as follows:

(A) One director shall be appointed by the Secretary of the Treasury from among the officers and employees of the Department of the Treasury.

(B) One director shall be appointed by the Federal Reserve Board from among the officers and employees of the Federal Reserve Board.

(C) Five directors shall be appointed by the President, by and with the advice and consent of the Senate, as follows—

(i) three such directors shall be selected from among persons who are associated with, and representative of different aspects of, the securities industry, not all of whom shall be from the same geographical area of the United States, and

(ii) two such directors shall be selected from the general public from among persons who are not associated with a broker or dealer or associated with a member of a national securities exchange, within the meaning of section 3(a)(18) or section 3(a)(21), respectively, of the 1934 Act [15 USCS § 78c(a)(18), (21)], or similarly associated with any sef-regulatory organization or other securities industry group, and who have not had any such association during the two years preceding appointment.

(3) *Chairman and vice chairman.* The President shall designate a Chairman and Vice Chairman from among those directors appointed under paragraph (2)(C)(ii) of this subsection.

(4) *Terms.* (A) Except as provided in subparagraphs (B) and (C), each director shall be appointed for a term of three years.

(B) Of the directors first appointed under paragraph (2) —

(i) two shall hold office for a term expiring on December 31, 1971,

(ii) two shall hold office for a term expiring on December 31, 1972, and

(iii) three shall hold office for a term expiring on December 31, 1973,

as designated by the President at the time they take office. Such designation shall be made in a manner which will assure that no two persons appointed under the authority of the same clause of para graph (2)(C) shall have terms which expire simultaneously.

(C) A vacancy in the Board shall be filled in the same manner as the original appointment was made. Any director appointed to fill a vacancy occurring prior to the expiration of the term for which his predecessor was appointed shall be appointed only for the remainder of such term. A director may serve after the expiration of his term until his successor has taken office.

(5) *Compensation.* All matters relating to compensation of directors shall be as provided in the bylaws of SIPC.

(d) Meetings of Board. The Board of Directors shall meet at the call of its Chairman, or as otherwise provided by the bylaws of SIPC.

(e) Bylaws and rules. (1) *Proposed bylaw changes.* The Board of Directors of SIPC shall file with the Commission a copy of any proposed bylaw or any proposed amendment to or repeal of any bylaw of SIPC (hereinafter in this paragraph collectively referred to as a "proposed bylaw change"), accompanied by a concise general statement of the basis and purpose of such proposed bylaw change. Each such proposed bylaw change shall take effect thirty days after the date of the filing of a copy thereof with the Commission, or upon such later date as SIPC may designate or such earlier date as the Commission may determine, unless —

(A) the Commission, by notice to SIPC setting forth the reasons therefor, disapproves such proposed bylaw change as being contrary to the public interest or contrary to the purposes of this Act; or

(B) the Commission finds that such proposed bylaw change involves a matter of such significant public interest that public comment should be obtained, in which case it may, after notifying SIPC in writing of such finding, require that the procedures set forth in paragraph (2) be followed with respect to such proposed bylaw change, in the same manner as if such proposed bylaw change were a proposed rule change within the meaning of such paragraph.

(2) *Proposed rule changes.* (A) Filing of proposed rule changes. The Board of Directors of SIPC shall file with the Commission, in accordance with such rules as the Commission may prescribe, a copy of any proposed rule or any proposed amendment to or repeal of any rule of SIPC (hereinafter in this subsection collectively referred to as a "proposed rule change"), accompanied by a concise general statement of the basis and purpose of such proposed rule change. The Commission shall, upon the filing

of any proposed rule change, publish notice thereof, together with the terms of substance of such proposed rule change or a description of the subjects and issues involved. The Commission shall give interested persons an opportunity to submit written data, views, and arguments with respect to such proposed rule change. No proposed rule change shall take effect unless approved by the Commission or otherwise permitted in accordance with the provisions of this paragraph.

(B) Action by the commission. Within thirty-five days after the date of publication of notice of the filing of a proposed rule change, or within such longer period as the Commission may designate of not more than ninety days after such date if it finds such longer period to be appropriate and publishes its reasons for so finding, or as to which SIPC consents, the Commission shall —

(i) by order approve such proposed rule change; or

(ii) institute proceedings to determine whether such proposed rule change should be disapproved.

(C) Proceedings. Proceedings instituted with respect to a proposed rule change pursuant to subparagraph (B)(ii) shall include notice of the grounds for disapproval under consideration and opportunity for hearing, and shall be concluded within one hundred eighty days after the date of publication of notice of the filing of such proposed rule change. At the conclusion of such proceedings, the Commission shall, by order, approve or disapprove such proposed rule change. The Commission may extend the time for conclusion of such proceedings for not more than sixty days if it finds good cause for such extension and publishes its reasons for so finding, or for such longer period as to which SIPC consents.

(D) Grounds for approval or dissapproval. The Commission shall approve a proposed rule change if its finds that such proposed rule change is in the public interest and is consistent with the purposes of this Act, and any proposed rule change so approved shall be given force and effect as if promulgated by the Commission. The Commission shall disapprove a proposed rule change if it does not make the finding referred to in the preceding sentence. The Commission shall not approve any proposed rule change prior to thirty days after the date of publication of notice of the filing thereof, unless the Commission finds good cause for so doing and publishes its reasons for so finding.

(E) Exception. Notwithstanding any other provision of this paragraph, a proposed rule change may take effect —

(i) upon the date of filing with the Commission, if such proposed rule change is designated by SIPC as relating solely to matters which the Commission, consistent with the public interest and the purposes of this subsection, determines by rule do not require the procedures set forth in this paragraph; or

(ii) upon such date as the Commission shall for good cause determine. Any proposed rule change which takes effect under this clause shall be filed promptly thereafter and reviewed in accordance with the provisions of subparagraph (A).

At any time within sixty days after the date of filing of any rule change which has taken effect pursuant to this subparagraph, the Commission may summarily abrogate such rule change and require that it be refiled and reviewed in accordance with the provisions of this paragraph, if the Commission finds that such action is neces-

sary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of this Act. Any action of the Commission pursuant to the preceding sentence shall not affect the validity or force of a rule change during the period it was in effect and shall not be reviewable under section 25 of the 1934 Act [15 USCS § 78y] or deemed to be final agency action for purposes of section 704 of title 5, United States Code [5 USCS § 704].

(3) *Action required by Commission.* The Commission may, by such rules as it determines to be necessary or appropriate in the public interest or to carry out the purposes of this Act, require SIPC to adopt, amend, or repeal any SIPC bylaw or rule, whenever adopted.

(Dec. 30, 1970, P. L. 91-598, § 3, 84 Stat. 1637; May 21, 1978, P. L. 95-283, §§ 2-5, 92 Stat. 249-251.)

§ 78ddd. SIPC Fund

(a) In general. (1) *Establishment of fund.* SIPC shall establish a "SIPC Fund" (hereinafter in this Act referred to as the "fund"). All amounts received by SIPC (other than amounts paid directly to any lender pursuant to any pledge securing a borrowing by SIPC) shall be deposited in the fund, and all expenditures made by SIPC shall be made out of the fund.

(2) *Balance of the fund.* Except as otherwise provided in this section, the balance of the fund at any time shall consist of the aggregate at such time of the following items:

(A) Cash on hand or on deposit.

(B) Amounts invested in United States Government or agency securities.

(C) Such confirmed lines of credit as SIPC may from time to time maintain, other than those maintained pursuant to paragraph (4).

(3) *Confirmed lines of credit.* For purposes of this section, the amount of confirmed lines of credit as of any time is the aggregate amount which SIPC at such time has the right to borrow from banks and other financial institutions under confirmed lines of credit or other written agreements which provide that moneys so borrowed are to be repayable by SIPC not less than one year from the time of such borrowings (including, for purposes of determining when such moneys are repayable, all rights of extension, refunding, or renewal at the election of SIPC).

(4) *Other lines.* SIPC may maintain such other confirmed lines of credit as it considers necessary or appropriate, and such other confirmed lines of credit shall not be included in the balance of the fund, but amounts received from such lines of credit may be disbursed by SIPC under this Act as though such amounts were part of the fund.

(b) Initial required balance for fund. Within one hundred and twenty days from the date of enactment of this Act [enacted Dec. 30, 1970], the balance of the fund shall aggregate not less than $75,000,000, less any amounts expended from the fund within that period.

(c) Assessments. (1) *Initial assessments.* Each member of SIPC shall pay to SIPC, or the collection agent for SIPC specified in section 9(a) [15 USCS § 78iii(a)], on or before the one hundred and twentieth day following the date of enactment of this Act [enacted Dec. 30, 1970], an assessment equal to one-eighth of 1 per centum of the gross revenues from the securities business of such mem-

ber during the calendar year 1969, or if the Commission shall determine that, for purposes of assessment pursuant to this paragraph, a lesser percentage of gross revenues from the securities business is appropriate for any class or classes of members (taking into account relevant factors, including but not limited to types of business done and nature of securities sold), such lesser percentages as the Commission, by rule or regulation, shall establish for such class or classes, but in no event less than one-sixteenth of 1 per centum for any such class. In no event shall any assessment upon a member pursuant to this paragraph be less than $150.

(2) *General assessment authority.* SIPC shall, by bylaw, impose upon its members such assessments as, after consultation with self-regulatory organizations, SIPC may deem necessary and appropriate to establish and maintain the fund and to repay any borrowings by SIPC. Any assessments so made shall be in conformity with contractual obligations made by SIPC in connection with any borrowing incurred by SIPC. Subject to paragraph (3) and subsection (d)(1)(A), any such assessment upon the members, or any one or more classes thereof, may, in whole or in part, be based upon or measured by (A) the amount of their gross revenues from the securities business, or (B) all or any of the following factors: the amount or composition of their gross revenues from the securities business, the number or dollar volume of transactions effected by them, the number of customer accounts maintained by them or the amounts of cash and securities in such accounts, their net capital, the nature of their activities (whether in the securities business or otherwise) and the consequent risks, or other relevant factors.

(3) *Limitations.* Notwithstanding any other provision of this Act —

(A) no assessment shall be made upon a member otherwise than pursuant to paragraph (1) or (2) of this subsection,

(B) an assessment may be made under paragraph (2) of this subsection at a rate in excess of one-half of one per centum during any twelve-month period if SIPC determines, in accordance with a bylaw, that such rate of assessment during such period will not have a material adverse effect on the financial condition of its members or their customers, except that no assessments shall be made pursuant to such paragraph upon a member which require payments during any such period which exceed in the aggregate one per centum of such member's gross revenues from the securities business for such period, and

(C) no assessment shall include any charge based upon the member's activities (i) in the distribution of shares of registered open end investment companies or unit investment trusts, (ii) in the sale of variable annuities, (iii) in the business of insurance, or (iv) in the business of rendering investment advisory services to one or more registered investment companies or insurance company separate accounts.

(d) Requirements respecting assessments and lines of credit. (1) *Assessments.* (A) ½ of 1 percent assessment. Subject to subsection (c)(3), SIPC shall impose upon each of its members an assessment at a rate of not less

than one-half of 1 per centum per annum of the gross revenues from the securities business of such member —

(i) until the balance of the fund aggregates not less than $150,000,000 (or such other amount as the Commission may determine in the public interest),

(ii) during any period when there is outstanding borrowing by SIPC pursuant to subsection (f) or subsection (g) of this section, and

(iii) whenever the balance of the fund (exclusive of confirmed lines of credit) is below $100,000,000 (or such other amount as the Commission may determine in the public interest).

(B) ¼ of 1 percent assessment. During any period during which —

(i) the balance of the fund (exclusive of confirmed lines of credit) aggregates less than $150,000,000 (or such other amount as the Commission has determined under paragraph (2)(B)), or

(ii) SIPC is required under paragraph (2)(B) to phase out of the fund all confirmed lines of credit,

SIPC shall endeavor to make assessments in such a manner that the aggregate assessments payable by its members during such period shall not be less than one-fourth of 1 per centum per annum of the aggregate gross revenues from the securities business for such members during such period.

(C) Minimum assessment. The minimum assessment imposed upon each member of SIPC shall be $25 per annum through the year ending December 31, 1979, and thereafter shall be the amount from time to time set by

SIPC bylaw, but in no event shall the minimum assessment be greater than $150 per annum.

(2) *Lines of credit.* (A) $50,000,000 limit after 1973. After December 31, 1973, confirmed lines of credit shall not constitute more than $50,000,000 of the balance of the fund.

(B) Phaseout requirement. When the balance of the fund aggregates $150,000,000 (or such other amount as the Commission may determine in the public interest) SIPC shall phase out of the fund all confirmed lines of credit.

(e) Prior trusts; overpayments and underpayments. (1) *Prior trusts.* There may be contributed and transferred at any time to SIPC any funds held by any trust established by a self-regulatory organization prior to January 1, 1970, and the amounts so contributed and transferred shall be applied, as may be determined by SIPC with approval of the Commission, as a reduction in the amounts payable pursuant to assessments made or to be made by SIPC upon members of such self-regulatory organization pursuant to subsection (c)(2). No such reduction shall be made at any time when there is outstanding any borrowing by SIPC pursuant to subsection (g) of this section or any borrowings under confirmed lines of credit.

(2) *Overpayments.* To the extent that any payment by a member exceeds the maximum rate permitted by subsection (c) of this section, the excess shall be recoverable only against future payments by such member, except as otherwise provided by SIPC bylaw.

(3) *Underpayments.* If a member fails to pay when due all or any part of an assessment made upon such member, the unpaid portion thereof shall bear interest at

such rate as may be determined by SIPC bylaw and, in addition to such interest, SIPC may impose such penalty charge as may be determined by SIPC bylaw. Any such penalty charge imposed upon a SIPC member shall not exceed 25 per centum of any unpaid portion of the assessment. SIPC may waive such penalty charge in whole or in part in circumstances where it considers such waiver appropriate.

(f) Borrowing authority. SIPC shall have the power to borrow moneys and to evidence such borrowed moneys by the issuance of bonds, notes, or other evidences of indebtedness, all upon such terms and conditions as the Board of Directors may determine in the case of a borrowing other than pursuant to subsection (g) of this section, or as may be prescribed (g). The interest payable on a borrowing pursuant to subsection (g) shall be equal to the interest payable on the related notes or other obligations issued by the Commission to the Secretary of the Treasury. To secure the payment of the principal of, and interest and premium, if any, on, all bonds, notes, or other evidences of indebtedness so issued, SIPC may make agreements with respect to the amount of future assessments to be made upon members and may pledge all or any part of the assets of SIPC and of the assessments made or to be made upon members. Any such pledge of future assessments shall (subject to any prior pledge) be valid and binding from the time that it is made, and the assessments so pledged and thereafter received by SIPC, or any collection agent for SIPC, shall immediately be subject to the lien of such pledge without any physical delivery thereof or further act, and the lien of such pledge shall be valid and binding against all parties having claims of any kind against SIPC or such collection agent whether pursuant to this Act, in tort, contract or otherwise, irrespective of whether such parties

have notice thereof. During any period when a borrowing by SIPC pursuant to subsection (g) of this section is outstanding, no pledge of any assessment upon a member to secure any bonds, notes, or other evidences of indebtedness issued other than pursuant to subsection (g) of this section shall be effective as to the excess of the payments under the assessment on such member during any twelve-month period over one-fourth of 1 per centum of such member's gross revenues from the securities business for such period. Neither the instrument by which a pledge is authorized or created, nor any statement or other document relative thereto, need be filed or recorded in any State or other jurisdiction. The Commission may by rule or regulation provide for the filing of any instrument by which a pledge or borrowing is authorized or created, but the failure to make or any defect in any such filing shall not affect the validity of such pledge or borrowing.

(g) SEC Loans to SIPC. In the event that the fund is or may reasonably appear to be insufficient for the purposes of this Act, the Commission is authorized to make loans to SIPC. At the time of application for, and as a condition to, any such loan, SIPC shall file with the Commission a statement with respect to the anticipated use of the proceeds of the loan. If the Commission determines that such loan is necessary for the protection of customers of brokers or dealers and the maintenance of confidence in the United States securities markets and that SIPC has submitted a plan which provides as reasonable an assurance of prompt repayment as may be feasible under the circumstances, then the Commission shall so certify to the Secretary of the Treasury, and issue notes or other obligations to the Secretary of the Treasury pursuant to subsection (h). If the Commission determines that the amount or time for payment of the assess-

ments pursuant to such plan would not satisfactorily provide for the repayment of such loan, it may, by rules and regulations, impose upon the purchasers of equity securities in transactions on national securities exchanges and in the over-the-counter markets a transaction fee in such amount as at any time or from time to time it may determine to be appropriate, but not exceeding one-fiftieth of 1 per centum of the purchase price of the securities. No such fee shall be imposed on a transaction (as defined by rules or regulations of the commission) of less than $5,000. For the purposes of the next preceding sentence, (1) the fee shall be based upon the total dollar amount of each purchase; (2) the fee shall not apply to any purchase on a national securities exchange or in an over-the-counter market by or for the account of a broker or dealer registered under section 15(b) of the 1934 Act [15 USCS § 78*o*(b)] unless such purchase is for an investment account of such broker or dealer (and for this purpose any transfer from a trading account to an investment account shall be deemed a purchase at fair market value); and (3) the Commission may, by rule, exempt any transaction in the the over-the-counter markets or on any national securities exchange where necessary to provide for the assessment of fees on purchasers in transactions in such markets and exchanges on a comparable basis. Such fee shall be collected by the broker or dealer effecting the transaction for or with the purchaser, or by such other person as provided by the commission by rule, and shall be paid to SIPC in the same manner as assessments imposed pursuant to subsection (c) but without regard to the limits on such assessments, or in such other manner as the Commission may by rule provide.

(h) SEC notes issed to Treasury. To enable the Commission to make loans under subsection (g), the Commission is authorized to issue to the Secretary of the

Treasury notes or other obligations in an aggregate amount of not to exceed $1,000,000,000, in such forms and denominations, bearing such maturities, and subject to such terms and conditions, as may be prescribed by the Secretary of the Treasury. Such notes or other obligations shall bear interest at a rate determined by the Secretary of the Treasury, taking into consideration the current average market yield on outstanding marketable obligations of the United States of comparable maturities during the month preceding the issuance of the notes or other obligations. The Secretary of the Treasury may reduce the interest rate if he determines such reduction to be in the national interest. The Secretary of the Treasury is authorized and directed to purchase any notes and other obligations issued hereunder and for that purpose he is authorized to use as a public debt transaction the proceeds from the sale of any securities issued under the Second Liberty Bond Act, as amended, and the purposes for which securities may be issued under that Act, as amended, are extended to include any purchase of such notes and obligations. The Secretary of the Treasury may at any time sell any of the notes or other obligations acquired by him under this subsection. All redemptions, purchases, and sales by the Secretary of the Treasury of such notes or other obligations shall be treated as public debt transactions of the United States.

(i) Consolidated group. Except as otherwise provided by SIPC bylaws, gross revenues from the securities business of a member of SIPC shall be computed on a consolidated basis for such member and all its subsidiaries (other than the foreign subsidiaries of such member), and the operations of a member of SIPC shall include those of any business to which such member has succeeded.

(Dec. 30, 1970, P. L. 91-598, § 4, 84 Stat. 1639; May 21, 1978, P. L. 95-283, § 6, 92 Stat. 253.)

§ 78eee. Protection of customers

(a) Determination of need of protection. (1) *Notice to SIPC.* If the Commission or any self-regulatory organization is aware of facts which lead it to believe that any broker or dealer subject to its regulation is in or is approaching financial difficulty, it shall immediately notify SIPC, and, if such notification is by a self-regulatory organization, the Commission.

(2) *Action by self-regulatory organization.* If a self-regulatory organization has given notice to SIPC pursuant to subsection (a)(1) with respect to a broker or dealer, and such broker or dealer undertakes to liquidate or reduce its business either pursuant to the direction of a self-regulatory organization or voluntarily, such self-regulatory organization may render such assistance or oversight to such broker or dealer as it considers appropriate to protect the interests of customers of such broker or dealer. The assistance or oversight by a self-regulatory organization shall not be deemed the assumption or adoption by such self-regulatory organization of any obligation or liability to customers, other creditors, shareholders, or partners of the broker or dealer, and shall not prevent or act as a bar to any action by SIPC.

(3) *Action by SIPC.* If SIPC determines that —

(A) any member of SIPC (including any person who was a member within one hundred eighty days prior to such determination) has failed or is in danger of failing to meet its obligations to customers; and

(B) one or more of the conditions specified in subsection (b)(1) exist with respect to such member.

SIPC may, upon notice to such member, file an application for a protective decree with any court of competent jurisdiction specified in section 21(e) or 27 of the 1934 Act [15 USCS §§ 78u(e), 78aa], except that no such application shall be filed with respect to a member the only customers of which are persons whose claims could not be satisfied by SIPC advances pursuant to section 9 [15 USCS § 78fff-3].

(4) *Effect of other pending actions.* An application with respect to a member of SIPC filed with a court under paragraph (3) —

(A) may, with the consent of the Commission, be combined with any action brought by the Commission, including an action by the Commission for a temporary receiver pending an appointment of a trustee under subsection (b)(3); and

(B) may be filed notwithstanding the pendency in the same or any other court of any bankruptcy, mortgage foreclosure, or equity receivership proceeding or any proceeding to reorganize, conserve, or liquidate such member or its property, or any proceeding to enforce a lien against property of such member.

(b) Court action. (1) *Issuance of protective decree.* Upon receipt of an application by SIPC under subsection (a)(3), the court shall forthwith issue a protective decree if the debtor consents thereto, if the debtor fails to contest such application, or if the court finds that such debtor —

(A) is insolvent within the meaning of section 101 of title 11 of the United States Code [11 USCS

§ 101], or is unable to meet its obligations as they mature;

(B) is the subject of a proceeding pending in any court or before any agency of the United States or any State in which a receiver, trustee, or liquidator for such debtor has been appointed;

(C) is not in compliance with applicable requirements under the 1934 Act or rules of the Commission or any self-regulatory organization with respect to financial responsibility or hypothecation of customers' securities; or

(D) is unable to make such computations as may be necessary to establish compliance with such financial responsibility or hypothecation rules.

Unless the debtor consents to the issuance of a protective decree, the application shall be heard three business days after the date on which it is filed, or at such other time as the court shall determine, taking into consideration the urgency which the circumstances require.

(2) *Jurisdiction and powers of court.* (A) Exclusive jurisdiction. Upon the filing of an application with a court for a protective decree with respect to a debtor, such court —

(i) shall have exclusive jurisdiction of such debtor and its property wherever located (including property located outside the territorial limits of such court and property held by any other person as security for a debt or subject to a lien);

(ii) shall have exclusive jurisdiction of any suit against the trustee with respect to a liquidation proceeding; and

(iii) except as inconsistent with the provisions of this Act, shall have the jurisdiction, powers, and duties conferred upon a court of the United States having jurisdiction over cases under title 11 of the United States Code [11 USCS §§ 101 et seq.],

(B) Stay of pending actions. Pending the issuance of a protective decree under paragraph (1), the court with which an application has been filed —

(i) shall stay any pending bankruptcy, mortgage foreclosure, equity receivership, or other proceeding to reorganize, conserve, or liquidate the debtor or its property and any other suit against any receiver, conservator, or trustee of the debtor or its property, and shall continue such stay upon appointment of a trustee pursuant to paragraph (3);

(ii) may stay any proceeding to enforce a lien against property of the debtor or any other suit against the debtor, including a suit by stockholders of the debtor which interferes with prosecution by the trustee of claims against former directors, officers, or employees of the debtor, and may continue such stay upon appointment of a trustee pursuant to paragraph (3);

(iii) may stay enforcement of, and upon appointment of a trustee pursuant to paragraph (3), may continue the stay for such period of time as may be appropriate, but shall not abrogate, any right of setoff, except to the extent such right may be affected under section 553 of title 11 of the United States Code [11 USCS § 553] and shall not abrogate the right to enforce a valid, nonpreferential lien or pledge against the property of the debtor; and

(iv) may appoint a temporary receiver.

(3) *Appointment of trustee and attorney.* If the court issues a protective decree under paragraph (1), such court shall forthwith appoint, as trustee for the liquidation of the business of the debtor and as attorney for the trustee, such persons as SIPC, in its sole discretion, specifies. The persons appointed as trustee and as attorney for the trustee may be associated with the same firm. SIPC may, in its sole discretion, specify itself or one of its employees as trustee in any case in which SIPC has determined that the liabilities of the debtor to unsecured general creditors and to subordinated lenders appear to aggregate less than $750,000 and that there appear to be fewer than five hundred customers of such debtor. No person may be appointed to serve as trustee or attorney for the trustee if such person is not disinterested within the meaning of paragraph (6), except that for any specified purpose other than to represent a trustee in conducting a liquidation proceeding, the trustee may, with the approval of SIPC and the court, employ an attorney who is not disinterested. A trustee appointed under this paragraph shall qualify by filing a bond in the manner prescribed by section 322 of title 11 of the United States Code [11 USCS § 322], except that neither SIPC nor any employee of SIPC shall be required to file a bond when appointed as trustee.

(4) *Removal to bankruptcy court.* Upon the issuance of a protective decree and appointement of a trustee, or a trustee and counsel, under this section, the court shall forthwith order the removal of the entire liquidation proceeding to the court of the United States in the same judicial district having jurisdiction over cases under title 11 [11 USCS §§ 101 et seq.]. The latter court shall thereupon have all of the jurisdiction, powers, and duties conferred by this Act upon the court to which application for the issuance of the protective decree was made.

(5) *Compensation for services and reimbursement of expenses.* (A) Allowances in general. The court shall grant reasonable compensation for services rendered and reimbursement for proper costs and expenses incurred (hereinafter in this paragraph referred to as "allowances") by a trustee, and by the attorney for such a trustee, in connection with a liquidation proceeding. No allowances (other than reimbursement for proper costs and expenses incurred) shall be granted to SIPC or any employee or SIPC for serving as trustee. Allowances may be granted on an interim basis during the course of the liquidation proceeding at such times and in such amounts as the court considers appropriate.

(B) Application for allowances. Any person seeking allowances shall file with the court an application which complies in form and content with the provisions of title 11 of the United States Code [11 USCS §§ 101 et seq.] governing applications for allowances under such title [11 USCS §§ 101 et seq.]. A copy of such application shall be served upon SIPC when filed. The court shall fix a time for a hearing on such application, and notice of such hearing shall be given to the applicant, the trustee, the debtor, the creditors, SIPC, and such other persons as the court may designate, except that notice need not be given to customers whose claims have been or will be satisfied in full or to creditors who cannot reasonably be expected to receive any distribution during the course of the liquidation proceeding.

(C) Recommendations of SIPC and awarding of allowances. Whenever an application for allowances is filed pursuant to subparagraph (B), SIPC shall file its recommendation with respect to such allowances with the court prior to the hearing on such application and shall, if it so requests, be allowed a reasonable time after such hearing

within which to file a further recommendation. In any case in which such allowances are to be paid by SIPC without reasonable expectation of recoupment thereof as provided in this Act and there is no difference between the amounts requested and the amounts recommended by SIPC, the court shall award the amounts recommended by SIPC. In determining the amount of allowances in all other cases, the court shall give due consideration to the nature, extent, and value of the services rendered, and shall place considerable reliance on the recommendation of SIPC.

(D) Applicable restrictions. The restrictions on sharing of compensation set forth in section 504 of title 11 of the United States Code [11 USCS § 504] shall apply to allowances.

(E) Charge against estate. Allowances granted by the court, including interim allowances, shall be charged against the general estate of the debtor as a cost and expense of administration. If the general estate is insufficient to pay allowances in whole or in part, SIPC shall advance such funds as are necessary for such payment.

(6) *Disinterestedness.* (A) Standards. For purposes of paragraph (3), a person shall not be deemed disinterested if —

(i) such person is a creditor (including a customer), stockholder, or partner of the debtor;

(ii) such person is or was an underwriter of any of the outstanding securities of the debtor or within five years prior to the filing date was the underwriter of any securities of the debtor;

(iii) such person is, or was within two years prior to the filing date, a director, partner, officer, or employee of the debtor or such an underwriter, or an attorney for the debtor or such an underwriter; or

(iv) it appears that such person has, by reason of any other direct or indirect relationship to, connection with, or interest in the debtor or such an underwriter, or for any other reason, an interest materially adverse to the interests of any class of creditors (including customers) or stockholders,

except that SIPC shall in all cases be deemed disinterested, and an employee of SIPC shall be deemed disinterested if such employee would, except for his association with SIPC, meet the standards set forth in this subparagraph.

(B) Hearing. The court shall fix a time for a hearing on disinterestedness, to be held promptly after the appointment of a trustee. Notice of such hearing shall be mailed at least ten days prior thereto to each person who, from the books and records of the debtor, appears to have been a customer of the debtor with an open account within the past twelve months, to the address of such person as it appears from the books and records of the debtor, and to the creditors and stockholders of the debtor, to SIPC, and to such other persons as the court may designate. The court may, in its discretion, also require that notice be given by publication in such newspaper or newspapers of general circulation as it may designate. At such hearing, at any adjournment thereof, or upon application, the court shall hear objections to the retention in office of a trustee or attorney for a trustee on the grounds that such person is not disinterested.

(c) SEC participation in proceedings. The Commission may, on its own motion, file notice of its appearance in any proceeding under this Act and may thereafter participate as a party.

(d) SIPC participation. SIPC shall be deemed to be a party in interest as to all matters arising in a liquidation proceeding, with the right to be heard on all such matters, and shall be deemed to have intervened with respect to all such matters with the same force and effect as if a petition for such purpose had been allowed by the court.

(Dec. 30, 1970, P. L. 91-598, § 5, 94 Stat. 1644; May 21, 1978, P. L. 95-283, § 7, 92 Stat. 254; Nov. 6, 1978, P. L. 95-598, Title III, § 308(a)-(f), 92 Stat. 2674, 2675.)

§ 78fff. General provisions of a liquidation proceeding

(a) Purposes. The purposes of a liquidation proceeding under this Act shall be —

(1) as promptly as possible after the appointment of a trustee in such liquidation proceeding, and in accordance with the provisions of this Act —

(A) to deliver customer name securities to or on behalf of the customers of the debtor entitled thereto as provided in section 8(c)(2) [15 USCS § 78fff-2(c)(2)]; and

(B) to distribute customer property and (in advance thereof or concurrently therewith) otherwise satisfy net equity claims of customers to the extent provided in this section;

(2) to sell or transfer offices and other productive units of the business of the debtor;

(3) to enforce rights of subrogation as provided in this Act; and

(4) to liquidate the business of the debtor.

(b) Application of title 11 of the United States Code [11 USCS §§ 101 et seq.]. To the extent consistent with the provisions of this Act, a liquidation proceeding shall be conducted in accordance with, and as though it were being conducted under chapters 1, 3, and 5 and subchapters I and II of chapter 7 of title 11 of the United States Code [11 USCS §§ 101 et seq., 301 et seq., 501 et seq., 701 et seq., 721 et seq.]. For the purposes of applying such title [11 USCS §§ 101 et seq.] in carrying out this section, a reference in such title [11 USCS §§ 101 et seq.] to the date of the filing of the petition shall be deemed to be a reference to the filing date under this Act.

(c) Determination of customer status. In a liquidation proceeding under this Act, whenever a person has acted with respect to cash or securities with the debtor after the filing date and in a manner which would have given him the status of a customer with respect to such cash or securities had the action occurred prior to the filing date, and the trustee is satisfied that such action was taken by the customer in good faith and prior to the appointment of the trustee, the date on which such action was taken shall be deemed to be the filing date for purposes of determining the net equity of such customer with respect to such cash or securities.

(d) Apportionment. In a liquidation proceeding under this Act, any cash or securities remaining after the liquidation of a lien or pledge made by a debtor shall be apportioned between his general estate and customer property in the proportion in which the general property of the debtor and the cash and securities of the customers of such debtor contributed to such lien or pledge. Securities apportioned to the general estate under this subsection shall be subject to the provisions of section 16(5)(A) [15 USCS § 78*lll*(5)(A)].

(e) Costs and expenses of administration. All costs and expenses of administration of the estate of the debtor and of the liquidation proceeding shall be borne by the general estate of the debtor to the extent it is sufficient therefor, and the priorities of distribution from the general estate shall be as provided in in section 726 of title 11 of the United States Code [11 USCS § 726]. Costs and expenses of administration shall include payments pursuant to section 8(e) and section 9(c)(1) [15 USCS §§ 78fff-2(e), 78fff-3(c)(1)] (to the extent such payments recovered securities which were apportioned to the general estate pursuant to subsection (d)) and costs and expenses of SIPC employees utilized by the trustee pursuant to section 7(a)(2) [15 USCS § 78fff-1(a)(2)]. All funds advanced by SIPC to a trustee for such costs and expenses of administration shall be recouped from the general estate under section 507(a)(1) of title 11 of the United States Code [11 USCS § 507(a)(1)].

(Dec. 30, 1970, P. L. 91-598, § 6, 84 Stat. 1646; May 21, 1978, P. L. 95-283, § 8, 92 Stat. 259; Nov. 6, 1978, P. L. 95-598, Title III, § 308(g), (h), 92 Stat. 2675.)

§ 78fff-1. Powers and duties of a trustee

(a) Trustee powers. A trustee shall be vested with the same powers and title with respect to the debtor and the property of the debtor, including the same rights to avoid preferences, as a trustee in a case under title 11 of the United States Code [11 USCS §§ 101 et seq.]. In addition, a trustee may, with the approval of SIPC but without any need for court approval —

(1) hire and fix the compensation of all personnel (including officers and employees of the debtor and of its examining authority) and other persons (including accountants) that are deemed by the trustee

necessary for all or any purposes of the liquidation proceeding;

(2) utilize SIPC employees for all or any purposes of a liquidation proceeding; and

(3) margin and maintain customer accounts of the debtor for the purposes of section 8(f) [75 USCS § 78fff-2(f)].

(b) Trustee duties. To the extent consistent with the provisions of this Act or as otherwise ordered by the court, a trustee shall be subject to the same duties as a trustee in a case under chapter 7 of title 11 of the United States Code [11 USCS §§ 701 et seq.], including, if the debtor is a commodity broker, as defined under section 101 of such title, the duties specified in subchapter IV of such chapter 7 [11 USCS §§ 761 et seq.], except that a trustee may, but shall have no duty to, reduce to money any securities constituting customer property or in the general estate of the debtor. In addition, the trustee shall —

(1) deliver securities to or on behalf of customers to the maximum extent practicable in satisfaction of customer claims for securities of the same class and series of an issuer; and

(2) subject to the prior approval of SIPC but without any need for court approval, pay or guarantee all or any part of the indebtedness of the debtor to a bank, lender, or other person if the trustee determines that the aggregate market value of securities to be made available to the trustee upon the payment or guarantee of such indebtedness does not appear to be less than the total amount of such payment or guarantee.

(c) Reports by trustee to court. The trustee shall make to the court and to SIPC such written reports as may be required of a trustee in a case under chapter 7 of title 11 of the United States Code [11 USCS §§ 701 et seq.], and shall include in such reports information with respect to the progress made in distributing cash and securities to customers. Such reports shall be in such form and detail as the Commission determines by rule to present fairly the results of the liquidation proceeding as of the date of or for the period covered by such reports, having due regard for the requirements of section 17 of the 1934 Act [15 USCS § 78q] and the rules prescribed under such section and the magnitude of items and transactions involved in connection with the operations of a broker or dealer.

(d) Investigations. The trustee shall —

(1) as soon as practicable, investigate the acts, conduct, property, liabilities, and financial condition of the debtor, the operation of its business, and any other matter, to the extent relevant to the liquidation proceeding, and report thereon to the court;

(2) examine, by deposition or otherwise, the directors and officers of the debtor and any other witnesses concerning any of the matters referred to in paragraph (1);

(3) report to the court any facts ascertained by the trustee with respect to fraud, misconduct, mismanagement, and irregularities, and to any causes of action available to the estate; and

(4) as soon as practicable, prepare and submit, to SIPC and such other persons as the court designates and in such form and manner as the court directs, a

statement of his investigation of matters referred to in paragraph (1).

(Dec. 30, 1970, P. L. 91-598, § 7, as added May 21, 1978, P. L. 95-283, § 9, 92 Stat. 260; Nov. 6, 1978, P. L. 95-598, Title III, § 308(i)-(k), 92 Stat. 2675.)

§ 78fff-2. Special provisions of a liquidation proceeding

(a) Notice and claims. (1) *Notice of proceedings.* Promptly after the appointment of the trustee, such trustee shall cause notice of the commencement of proceedings under this section to be published in one or more newspapers of general circulation in the form and manner determined by the court, and at the same time shall cause a copy of such notice to be mailed to each person who, from the books and records of the debtor, appears to have been a customer of the debtor with an open account within the past twelve months, to the address of such person as it appears from the books and records of the debtor. Notice to creditors other than customers shall be given in the manner prescribed by title 11 of the United States Code [11 USCS §§ 101 et seq.], except that such notice shall be given by the trustee.

(2) *Statement of claim.* A customer shall file with the trustee a written statement of claim but need not file a formal proof of claim, except that no obligation of the debtor to any person associated with the debtor within the meaning of section 3(a)(18) or section 3(a)(21) of the 1934 Act [15 USCS § 78c(a)(18), (21)], any beneficial owner of 5 per centum or more of the voting stock of the debtor, or any member of the immediate family of any such person or owner may be satisfied without formal proof of claim.

(3) *Time limitations.* No claim of a customer or other creditor of the debtor which is received by the trustee

after the expiration of the six-month period beginning on the date of publication of notice under paragraph (1) shall be allowed, except that the court may, upon application within such period and for cause shown, grant a reasonable, fixed extension of time for the filing of a claim by the United States, by a State or political subdivision thereof, or by an infant or incompetent person without a guardian. Any claim of a customer for net equity which is received by the trustee after the expiration of such period of time as may be fixed by the court (not exceeding sixty days after the date of publication of notice under paragraph (1)) need not be paid or satisfied in whole or in part out of customer property, and, to the extent such claim is satisfied from moneys advanced by SIPC, it shall be satisfied in cash or securities (or both) as the trustee determines is most economical to the estate.

(4) *Effect on claims.* Except as otherwise provided in this section, and without limiting the powers and duties of the trustee to discharge obligations promptly as specified in this section, nothing in this section shall limit the right of any person, including any subrogee, to establish by formal proof or otherwise as the court may provide such claims as such person may have against the debtor, including claims for the payment of money and the delivery of specific securities, without resort to moneys advanced by SIPC to the trustee.

(b) Payments to customers. After receipt of a written statement of claim pursuant to subsection (a)(2), the trustee shall promptly discharge, in accordance with the provisions of this section, all obligations of the debtor to a customer relating to, or net equity claims based upon, securities or cash, by the delivery of securities or the making of payments to or for the account of such customer (subject to the provisions of subsection (d) and

section 9(a) [15 USCS § 78fff-3(a)]) insofar as such obligations are ascertainable from the books and records of the debtor or are otherwise established to the satisfaction of the trustee. For purposes of distributing securities to customers, all securities shall be valued as of the close of business on the filing date. For purposes of this subsection, the court shall, among other things —

(1) with respect to net equity claims, authorize the trustee to satisfy claims out of moneys made available to the trustee by SIPC notwithstanding the fact that there has not been any showing or determination that there are sufficient funds of the debtor available to satisfy such claims; and

(2) with respect to claims relating to, or net equities based upon, securities of a class and series of an issuer which are ascertainable from the books and records of the debtor or are otherwise established to the satisfaction of the trustee, authorize the trustee to deliver securities of such class and series if and to the extent available to satisfy such claims in whole or in part, with partial deliveries to be made pro rata to the greatest extent considered practicable by the trustee.

Any payment or delivery of property pursuant to this subsection may be conditioned upon the trustee requiring claimants to execute, in a form to be determined by the trustee, appropriate receipts, supporting affidavits, releases, and assignments, but shall be without prejudice to any right of a claimant to file formal proof of claim within the period specified in subsection (a)(3) for any balance of securities or cash to which such claimant considers himself entitled.

(c) Customer related property. (1) *Allocation of customer property.* The trustee shall allocate customer property of the debtor as follows:

(A) first, to SIPC in repayment of advances made by SIPC pursuant to section 9(c)(1) [15 USCS § 78fff-3(c)(1)], to the extent such advances recovered securities which were apportioned to customer property pursuant to section 6(d) [15 USCS § 73fff(d)];

(B) second, to customers of such debtor, who shall share ratably in such customer property on the basis and to the extent of their respective net equities;

(C) third, to SIPC as subrogee for the claims of customers;

(D) fourth, to SIPC in repayment of advances made by SIPC pursuant to section 9(c)(2) [15 USCS § 78fff-3(c)(2)].

Any customer property remaining after allocation in accordance with this paragraph shall become part of the general estate of the debtor. To the extent customer property and SIPC advances pursuant to section 9(a) [15 USCS § 78fff-3(a)] are not sufficient to pay or otherwise satisfy in full the net equity claims of customers, such customers shall be entitled, to the extent only of their respective unsatisfied net equities, to participate in the general estate as unsecured creditors. For purposes of allocating customer property under this paragraph, securities to be delivered in payment of net equity claims for securities of the same class and series of an issuer shall be valued as of the close of business on the filing date.

(2) *Delivery of customer name securities.* The trustee shall deliver customer name securities to or on behalf of a

customer of the debtor entitled thereto if the customer is not indebted to the debtor. If the customer is so indebted, such customer may, with the approval of the trustee, reclaim customer name securities upon payment to the trustee, within such period of time as the trustee determines, of all indebtedness of such customer to the debtor.

(3) *Recovery of transfers.* Whenever customer property is not sufficient to pay in full the claims set forth in subparagraphs (A) through (D) of paragraph (1), the trustee may recover any property transferred by the debtor which, except for such transfer, would have been customer property if and to the extent that such transfer is voidable or void under the provisions of title 11 of the United States Code (11 USCS §§ 101 et seq.]. Such recovered property shall be treated as customer property. For purposes of such recovery, the property so transferred shall be deemed to have been the property of the debtor and, if such transfer was made to a customer or for his benefit, such customer shall be deemed to have been a creditor, the laws of any State to the contrary notwithstanding.

(d) Purchase of securities. The trustee shall, to the extent that securities can be purchased in a fair and orderly market, purchase securities as necessary for the delivery of securities to customers in satisfaction of their claims for net equities based on securities under section 7(b)(1) [15 USCS § fff-1(b)(1)] and for the transfer of customer accounts under subsection (f), in order to restore the accounts of such customers as of the filing date. To the extent consistent with subsection (c), customer property and moneys advanced by SIPC may be used by the trustee to pay for securities so purchased. Moneys advanced by SIPC for each account of a separate customer may not be used to purchase securities to the

extent that the aggregate value of such securities on the filing date exceeded the amount permitted to be advanced by SIPC under the provisions of section 9(a) [15 USCS § fff-3(a)].

(e) Closeouts. (1) *In general.* Any contract of the debtor for the purchase or sale of securities in the ordinary course of its business with other brokers or dealers which is wholly executory on the filing date shall not be completed by the trustee, except to the extent permitted by SIPC rule. Upon the adoption by SIPC of rules with respect to the closeout of such a contract but prior to the adoption of rules with respect to the completion of such a contract, the other broker or dealer shall close out such contract, without unnecessary delay, in the best available market and pursuant to such SIPC rules. Until such time as SIPC adopts rules with respect to the completion or closeout of such a contract, such a contract shall be closed out in accordance with Commission Rule S6(d)-1 as in effect on the date of enactment of this section [enacted May 21, 1978], or any comparable rule of the Commission subsequently adopted, to the extent not inconsistent with the provisions of this subsection.

(2) *Net profit or loss.* A broker or dealer shall net all profits and losses on all contracts closed out under this subsection and —

(A) if such broker or dealer shows a net profit on such contracts, he shall pay net profit to the trustee; and

(B) if such broker or dealer sustains a net loss on such contracts, he shall be entited to file a claim against the debtor with the trustee in the amount of such net loss.

To the extent that a net loss sustained by a broker or dealer arises from contracts pursuant to which such broker or dealer was acting for its own customer, such broker or dealer shall be entitled to receive funds advanced by SIPC to the trustee in the amount of such loss, except that such broker or dealer may not receive more than $40,000 for each separate customer with respect to whom it sustained a loss. With resepct to a net loss which is not payable under the preceding sentence from funds advanced by SIPC, the broker or dealer shall be entitled to participate in the general estate as an unsecured creditor.

(3) *Registered clearing agencies.* Neither a registered clearing agency which by its rules has an established procedure for the closeout of open contracts between an insolvent broker or dealer and its participants, nor its participants to the extent such participants' claims are or may be processed within the registered clearing agency, shall be entitled to receive SIPC funds in payment of any losses on such contracts, except as SIPC may otherwise provide by rule. If such registered clearing agency or its participants sustain a net loss on the closeout of such contracts with the debtor, they shall have the right to participate in the general estate as unsecured creditors to the extent of such loss. Any funds or other property owed to the debtor, after the closeout of such contracts, shall be promptly paid to the trustee. Rules adopted by SIPC under this paragraph shall provide that in no case may a registered clearing agency or its participants, to the extent such participants' claims are or may be processed within the registered clearing agency, be entitled to receive funds advanced by SIPC in an amount greater, in the aggregate, than could be received by the participants if such participants proceeded individually under paragraphs (1) and (2).

(4) *Definition.* For purposes of this subsection, the term "customer" does not include any person who —

(A) is a broker or dealer;

(B) had a claim for cash or securities which by contract, agreement, or understanding, or by operation of law, was part of the capital of the claiming broker or dealer or was subordinated to the claims of any or all creditors of such broker or dealer; or

(C) had a relationship of the kind specified in section 9(a)(5) [15 USCS § 78fff-3(a)(5)] with the debtor.

A claiming broker or dealer shall be deemed to have been acting on behalf of its customer if it acted as agent for such customer or if it held such customer's order which was to be executed as a part of its contract with the debtor.

(f) Transfer of customer accounts. In order to facilitate the prompt satisfaction of customer claims and the orderly liquidation of the debtor, the trustee may, pursuant to terms satisfactory to him and subject to the prior approval of SIPC, sell or otherwise transfer to another member of SIPC, without consent of any customer, all or any part of the account of a customber of the debtor. In connection with any such sale or transfer to another member of SIPC and subject to the prior approval of SIPC, the trustee may —

(1) waive or modify the need to file a written statement of claim pursuant to subsection (a)(2); and

(2) enter into such agreements as the trustee considers appropriate under the circumstances to indemnify any such member of SIPC against

shortages of cash or securities in the costomer accounts sold or transferred.

The funds of SIPC may be made available to guarantee or secure any indemnification under paragraph (2). The prior approval of SIPC to such indemnification shall be conditioned, among such other standards as SIPC may determine, upon a determination of SIPC that the probable cost of any such indemnification can reasonably be expected not to exceed the cost to SIPC of proceeding under section 9(a) and section 9(b) [15 USCS §78fff-3(a), (b)].

(Dec. 30, 1970, P. L. 91-598, § 8, as added May 21, 1978, P. L. 95-283, § 9, 92 Stat. 261; Nov. 6, 1978, P. L. 95-598, Title III, § 308*(1)*, (m), 92 Stat. 2675.)

§ 78fff-3. SIPC advances

(a) Advances for customers' claims. In order to provide for prompt payment and satisfaction of net equity claims of customers of debtor, SIPC shall advance to the trustee such moneys, not to exceed $500,000 for each customer, as may be required to pay or otherwise satisfy claims for the amount by which the net equity of each customer exceeds his ratable share of customer property, except that —

(1) if all or any portion of the net equity claim of a customer in excess of his ratable share of customer property is a claim for cash, as distinct from a claim for securities, the amount advanced to satisfy such claim for cash shall not exceed $100,000 for each such customer;

(2) a customer who holds accounts with the debtor in separate capacities shall be deemed to be a different customer in each capacity;

(3) if all or any portion of the net equity claim of a customer in excess of hi' ratable share of customer property is satisfied b' the delivery of securities purchased by the trustee pursuant to section 8(d) [15 USCS § 78fff-2(d)], the securities so purchased shall be valued as of the filing date for purposes of applying the dollar limitations of this subsection;

(4) no advance shall be made by SIPC to the trustee to pay or otherwise satisfy, directly or indirectly, any net equity claim of a customer who is a general partner, officer, or director of the debtor, a beneficial owner of five per centum or more of any class of equity security of the debtor (other than a nonconvertible stock having fixed preferential dividend and liquidation rights), a limited partner with a participation of five per centum or more in the net assets or net profits of the debtor, or a person who, directly or indirectly and through agreement or otherwise, exercised or had the power to exercise a controlling influence over the management or policies of the debtor; and

(5) no advance shall be made by SIPC to the trustee to pay or otherwise satisfy any net equity claim of any customer who is a broker or dealer or bank, other than to the extent that it shall be established to the satisfaction of the trustee, from the books and records of the debtor or from the books and records of a broker or dealer or bank, or otherwise, that the net equity claim of such broker or dealer or bank against the debtor arose out of transactions for customers of such broker or dealer or bank (which customers are not themselves a broker or dealer or bank or a person described in paragraph (4)), in which event each such customer of such

broker or dealer or bank shall be deemed a separate customer of the debtor.

To the extent moneys are advanced by SIPC to the trustee to pay or otherwise satisfy the claims of customers, in addition to all other rights it may have at law or in equity, SIPC shall be subrogated to the claims of such customers with the rights and priorities provided in this Act, except that SIPC as subrogee may assert no claim against customer property until after the allocation thereof to customers as provided in section 8(c) [15 USCS § 78fff-2(c)].

(b) Other advances. SIPC shall advance to the trustee —

(1) such moneys as may be required to carry out section 8(e) [15 USCS § 78fff-2(e)]; and

(2) to the extent the general estate of the debtor is not sufficient to pay any and all costs and expenses of administration of the estate of the debtor and of the liquidation proceeding, the amount of such costs and expenses.

(c) Discretionary advances. SIPC may advance to the trustee such moneys as may be required to —

(1) pay or guarantee indebtedness of the debtor to a bank, lender, or other person under section 7(b)(2) [15 USCS § 78fff-1(b)(2)];

(2) guarantee or secure any indemnity under section 8(f) [15 USCS § 78fff-2(f)]; and

(3) purchase securities under section 8(d) [15 USCS § 78fff-2(d)].

(Dec. 30, 1970, P. L. 91-598, § 9, as added May 21, 1978, P. L. 95-283, § 9, 92 Stat. 265; Oct. 10, 1980, P. L. 96-433, § 1, 94 Stat. 1955.)

§ 78fff-4. Direct payment procedure

(a) Determination regarding direct payments. If SIPC determines that —

(1) any member of SIPC (including a person who was a member within one hundred eighty days prior to such determination) has failed or is in danger of failing to meet its obligations to customers;

(2) one or more of the conditions specified in section 5(b)(1) [15 USCS § 78eee(b)(1)] exist with respect to such member;

(3) the claim of each customer of the member is within the limits of protection provided in section 9(a) [15 USCS § 78fff-3(a)];

(4) the claims of all customers of the member aggregate less than $250,000;

(5) the cost to SIPC of satisfying customer claims under this section will be less than the cost under a liquidation proceeding; and

(6) such member's registration as a broker-dealer under section 15(b) of the 1934 Act [15 USCS § 78o] has been terminated, or such member has consented to the use of the direct payment procedure set forth in this section,

SIPC may, in its discretion, use the direct payment procedure set forth in this section in lieu of instituting a liquidation proceeding with respect to such member.

(b) Notice. Promptly after a determination under subsection (a) that the direct payment procedure is to be used with respect to a member, SIPC shall cause notice of such direct payment procedure to be published in one or more newspapers of general circulation in a form and manner determined by SIPC, and at the same time shall cause to be mailed a copy of such notice to each person who appears, from the books and records of such member, to have been a customer of the member with an open account within the past twelve months, to the address of such person as it appears from the books and records of such member. Such notice shall state that SIPC will satisfy customer claims directly, without a liquidation proceeding, and shall set forth the form and manner in which claims may be presented. A direct payment procedure shall be deemed to commence on the date of first publication under this subsection and no claim by a customer shall be paid or otherwise satisfied by SIPC unless received within the six-month period beginning on such date, except that SIPC shall, upon application within such period, and for cause shown, grant a reasonable, fixed extension of time for the filing of a claim by the United States, by a State or political subdivision thereof, or by an infant or incompetent person without a guardian.

(c) Payments to customers. SIPC shall promptly satisfy all obligations of the member to each of it [its] customers relating to, or net equity claims based upon, securities or cash by the delivery of securities or the effecting of payments to such customer (subject to the provisions of section 8(d) and section 9(a) [15 USCS §§ 78fff-2(d), 78fff-3(a)]) insofar as such obligations are ascertainable from the books and records of the member or are otherwise established to the satisfaction of SIPC. For purposes of distributing securities to customers, all securities shall be valued as of the close of business on the

date of publication under subsection (b). Any payment or delivery of securities pursuant to this section may be conditioned upon the execution and delivery, in a form to be determined by SIPC, of appropriate receipts, supporting affidavits, releases, and assignments. To the extent moneys of SIPC are used to satisfy the claims of customers, in addition to all other rights it may have at law or in equity, SIPC shall be subrogated to the claims of such customers against the member.

(d) Effect on claims. Except as otherwise provided in this section, nothing in this section shall limit the right of any person, including any subrogee, to establish by formal proof or otherwise such claims as such person may have against the member, including claims for the payment of money and the delivery of specific securities, without resort to moneys of SIPC.

(e) Jurisdiction of Bankruptcy Courts. After SIPC has published notice of the institution of a direct payment procedure under this section, any person aggrieved by any determination of SIPC with respect to his claim under subsection (c) may, within six months following mailing by SIPC of its determination with respect to such claim, seek a final adjudication of such claim. The courts of the United States having jurisdiction over cases under title 11 of the United States Code [11 USCS §§ 101 et seq.] shall have original and exclusive jurisdiction of any civil action for the adjudication of such claim. Any such action shall be brought in the judicial district where the head office of the debtor is located. Any determination of the rights of a customer under subsection (c) shall not prejudice any other right or remedy of the customer against the member.

(f) Discontinuance of direct payment procedures. If, at any time after the institution of a direct payment

procedure with respect to a member, SIPC determines, in its discretion, that continuation of such direct payment procedure is not appropriate, SIPC may cease such direct payment procedure and, upon so doing, may seek a protective decree pursuant to section 5 [15 USCS § 78eee]. To the extent payments of cash, distributions of securities, or determinations with respect to the validity of a customer's claim are made under this section, such payments, distributions, and determinations shall be recognized and given full effect in the event of any subsequent liquidation proceeding. Any action brought under subsection (e) and pending at the time of the appointment of a trustee under section 5(b)(3) [15 USCS § 78eee(b)(3)] shall be permanently stayed by the court at the time of such appointment, and the court shall enter an order directing the transfer or removal to it of such suit. Upon such removal or transfer the complaint in such action shall constitute the plaintiff's claim in the liquidation proceeding, if appropriate, and shall be deemed received by the trustee on the date of his appointment regardless of the date of actual transfer or removal of such action.

(g) References. For purposes of this section, any reference to the trustee in sections 7(b)(1), 8(d), 8(f), 9(a), 16(5) and 16(12) [15 USCS §§ 78fff-1(b)(1), 78fff-2(d), (f), 78fff-3(a), and 78lll(5), (12)] shall be deemed a reference to SIPC, and any reference to the date of publication of notice under section 8(a) [15 USCS § 78fff-2(a)] shall be deemed a reference to the publication of notice under this section.

(Dec. 30, 1970, P. L. 91-598, § 10, as added May 21, 1978, P. L. 95-283, § 9, 92 Stat. 266; Nov. 6, 1978, P. L. 95-598, Title III, § 308(n), 92 Stat. 2675.)

§ 78ggg. SEC functions

(a) Administrative procedure. Determinations of the Commission, for purposes of making rules pursuant to section 3(e)(3) and 13(f) [15 USCS §§ 78ccc(e)(3), 78iii(f)] shall be after appropriate notice and opportunity for a hearing, and for submission of views of interested persons, in accordance with the rulemaking procedures specified in section 553 of title 5, United States Code [5 USCS § 553], but the holding of a hearing shall not prevent adoption of any such rule or regulation upon expiration of the notice period specified in subsection (d) of such section [5 USCS § 553(d)] and shall not be required to be on a record within the meaning of subchapter II of chapter 5 of such title [5 USCS §§ 551 et seq.].

(b) Enforcement of actions. In the event of the refusal of SIPC to commit its funds or otherwise to act for the protection of customers of any member of SIPC, the Commission may apply to the district court of the United States in which the principal office of SIPC is located for an order requiring SIPC to discharge its obligations under this Act and for such other relief as the court may deem appropriate to carry out the purposes of this Act.

(c) Examinations and reports. (1) *Examination of SIPC, etc.* The Commission may make such examinations and inspections of SIPC and require SIPC to furnish it with such reports and records or copies thereof as the Commission may consider necessary or appropriate in the public interest or to effectuate the purposes of this Act.

(2) *Reports from SIPC.* As soon as practicable after the close of each fiscal year, SIPC shall submit to the Commission a written report relative to the conduct of its business, and the exercise of the other rights and powers

granted by this Act, during such fiscal year. Such report shall include financial statements setting forth the financial position of SIPC at the end of such fiscal year and the results of its operations (including the source and application of its funds) for such fiscal year. The financial statements so included shall be examined by an independent public accountant or firm of independent public accountants, selected by SIPC and satisfactory to the Commission, and shall be accompanied by the report thereon of such accountant or firm. The Commission shall transmit such report to the President and the Congress with such comment thereon as the Commission may deem appropriate.

(Dec. 30, 1970, P. L. 91-598, § 11[7](a)-(c), 84 Stat. 1652; May 21, 1978, P. L. 95-283, §§ 9, 10, 92 Stat. 260, 268.)

§ 78hhh. Examining authority functions

Each member of SIPC shall file with such member's examining authority, or collection agent if a collection agent has been designated pursuant to section 13(a) [15 USCS § 78iii(a)], such information (including reports of, and information with respect to, the gross revenues from the securities business of such member, including the composition thereof, transactions in securities effected by such member, and other information with respect to such member's activities, whether in the securities business or otherwise, including customer accounts maintained, net capital employed, and activities conducted) as SIPC may determine to be necessary or appropriate for the purpose of making assessments under section 4 [15 USCS § 78ddd]. The examining authority or collection agent shall file with SIPC all or such part of such information (and such compilations and analyses thereof) as SIPC,

by bylaw or rule, shall prescribe. No application, report, or document filed pursuant to this section shall be deemed to be filed pursuant to section 18 of the 1934 Act [15 USCS § 78r].

(Dec. 30, 1970, P. L. 91-598, § 12[8], 84 Stat. 1653; May 21, 1978, P. L. 95-283, §§ 9, 11, 92 Stat. 260, 268.)

§ 78iii. Functions of self-regulatory organizations

(a) Collection agent. Each self-regulatory organization shall act as collection agent for SIPC to collect the assessments payable by all members of SIPC for whom such self-regulatory organization is the examining authority, unless SIPC designates a self-regulatory organization other than the examining authority to act as collection agent for any member of SIPC who is a member of or participant in more than one self-regulatory organization. If the only self-regulatory organization of which a member of SIPC is a member or in which it is a participant is a registered clearing agency that is not the examining authority for the member, SIPC may, nevertheless, designate such registered clearing agency as collection agent for the member or may require that payments be made directly to SIPC. The collection agent shall be obligated to remit to SIPC assessments made under section 4 [15 USCS § 78ddd] only to the extent that payments of such assessment are received by such collection agent. Members of SIPC who are not members of or participants in a self-regulatory organization shall make payments directly to SIPC.

(b) Immunity. No self-regulatory organization shall have any liability to any person for any action taken or omitted in good faith pursuant to section 5(a)(1) and section 5(a)(2) [15 USCS § 78eee(a)(1), (2)].

(c) Inspections. The self-regulatory organization of which a member of SIPC is a member or in which it is a participant shall inspect or examine such member for compliance with applicable financial responsibility rules, except that —

(1) if the self-regulatory organization is a registered clearing agency, the Commission may designate itself as responsible for the examination of such member for compliance with applicable financial responsibility rules; and

(2) if a member of SIPC is a member of or participant in more than one self-regulatory organization, the Commission, pursuant to section 17(d) of the 1934 Act [15 USCS § 78q(d)], shall designate one of such self-regulatory organizations or itself as responsible for the examination of such member for compliance with applicable financial responsibility rules.

(d) Reports. There shall be filed with SIPC by the self-regulatory organizations such reports of inspections or examinations of the members of SIPC (or copies thereof) as may be designated by SIPC by bylaw or rule.

(e) Consultation. SIPC shall consult and cooperate with the self-regulatory organizations toward the end:

(1) that there may be developed and carried into effect procedures reasonably designed to detect approaching financial difficulty upon the part of any member of SIPC;

(2) that, as nearly as may be practicable, examinations to ascertain whether members of SIPC are in compliance with applicable financial responsibility rules will be conducted by the self-regulatory organizations under appropriate standards (both as to

method and scope) and reports of such examinations will, where appropriate, be standard in form; and

(3) that, as frequently as may be practicable under the circumstances, each member of SIPC will file financial information with, and be examined by, the self-regulatory organization which is the examining authority for such member.

(f) Financial condition of members. The Commission may, by such rules as it determines necessary or appropriate in the public interest and to carry out the purposes of this Act, require any self-regulatory organization to furnish SIPC with reports and records (or copies thereof) relating to the financial condition of members of or participants in such self-regulatory organization.

(Dec. 30, 1970, P. L. 91-598, § 13[9], 84 Stat. 1654; June 4, 1975, P. L. 94-29, § 26, 89 Stat. 163; May 21, 1978, P. L. 95-283, §§ 9, 12 92 Stat. 260, 269.)

§ 78jjj. Prohibited Acts

(a) Failure to pay assessment, etc. If a member of SIPC shall fail to file any report or information required pursuant ot this Act, or shall fail to pay when due all or any part of an assessment made upon such member pursuant to this Act, and such failure shall not have been cured, by the filing of such report or information or by the making of such payment, together with interest and penalty thereon, within five days after receipt by such member of written notice of such failure given by or on behalf of SIPC, is shall be unlawful for such member, unless specifically authorized by the Commission, to engage in business as a broker or dealer. If such member denies that it owes all or any part of the amount specified in such notice, it may after payment of the full amount so specified commence an action against SIPC in the appropriate

United States district court to recover the amount it denies owing.

(b) Engaging in business after appointment of trustee or initiation of direct payment procedure. It shall be unlawful for any broker or dealer for whom a trustee has been appointed pursuant to this Act or for whom a direct payment procedure has been initiated to engage thereafter in business as a broker or dealer, unless the Commission otherwise determines in the public interest. The Commission may by order bar or suspend for any period, any officer, director, general partner, owner of 10 per centum or more of the voting securities, or controlling person of any broker or dealer for whom a trustee has been appointed pursuant to this Act or for whom a direct payment procedure has been initiated from being or becoming associated with a broker or dealer, if after appropriate notice and opportunity for hearing, the Commission shall determine such bar or suspension to be in the public interest.

(c) Concealment of assets; false statements or claims. (1) *Specific prohibited acts.* Any person who, directly or indirectly, in connection with or in contemplation of any liquidation proceeding or direct payment procedure —

(A) employs any device, scheme, or artifice to defraud;

(B) engages in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person; or

(C) fraudulently or with intent to defeat this Act

(i) conceals or transfers any property belonging to the estate of a debtor;

(ii) makes a false statement or account;

(iii) presents or uses any false claim for proof against the estate of a debtor;

(iv) receives any material amount of property from a debtor;

(v) gives, offers, receives, transfers, or obtains any money or property, remuneration, compensation, reward, advantage, other consideration, or promise thereof, for acting or forebearing to act;

(vi) conceals, destroys, mutilates, falsifies, makes a false entry in, or otherwise falsifies any document affecting or relating to the property or affairs of a debtor; or

(vii) withholds, from any person entitled to its possession, any document affecting or relating to the property or affairs of a debtor,

shall be fined not more than $50,000 or imprisoned for not more than five years, or both.

(2) *Fraudulent conversion.* Any person who, directly or indirectly steals, embezzles, or fraudulently, or with intent to defeat this Act, abstracts or converts to his own use or to the use of another any of the moneys, securities, or other assets of SIPC, or otherwise defrauds or attempts to defraud SIPC or a trustee by any means, shall be fined not more than $50,000 or imprisoned not more than five years, or both.

(Dec. 30, 1970, P. L. 91-598, § 14[10]; 84 Stat. 1655; May 21, 1978, P. L. 95-283, §§ 9, 13, 92 Stat. 260, 269.)

§ 78kkk. Miscellaneous provisions

(a) Public inspection of reports. Any notice, report, or other document filed with SIPC pursuant to this Act

shall be available for public inspection unless SIPC or the Commission shall determine that disclosure thereof is not in the public interest. Nothing herein shall act to deny documents or information to the Congress of the United States or the committees of either House having jurisdiction over financial institutions, securities regulation, or related matters under the rules of each body. Nor shall the Commission be denied any document or information which the Commission, in its judgment, needs.

(b) Liability of members of SIPC. Except for such assessments as may be made upon such member pursuant to the provisions of section 4 [15 USCS § 78ddd], no member of SIPC shall have any liability under this Act as a member of SIPC for, or in connection with, any act or omission of any other broker or dealer whether in connection with the conduct of the business or affairs of such broker or dealer or otherwise and, without limiting the generality of the foregoing, no member shall have any liability for or in respect of any indebtedness or other liability of SIPC.

(c) Liability of SIPC and Directors, officers, or employees. Neither SIPC nor any of its Directors, officers, or employees shall have any liability to any person for any action taken or omitted in good faith under or in connection with any matter contemplated by this Act.

(d) Advertising. SIPC shall by bylaw prescribe the manner in which a member of SIPC may display any sign or signs (or include in any advertisement a statement) relating to the protection to customers and their accounts, or any other protections, afforded under this Act. No member may display any such sign, or include in an advertisement any such statement, except in accordance with such bylaws. SIPC may also by bylaw prescribe such minimal requirements as it considers necessary and ap-

propriate to require a member of SIPC to provide public notice of its membership in SIPC.

(e) SIPC exempt from taxation. SIPC, its property, its franchise, capital, reserves, surplus, and its income, shall be exempt from all taxation now or hereafter imposed by the United States or by any State or local taxing authority, except that any real property and any tangible personal property (other than cash and securities) of SIPC shall be subject to State and local taxation to the same extent according to its value as other real and tangible personal property is taxed. Assessments made upon a member of SIPC shall constitute ordinary and necessary expenses in carrying on the business of such member for the purpose of section 162(a) of the Internal Revenue Code of 1954 [26 USCS § 162(a)]. The contribution and transfer to SIPC of funds or securities held by any trust established by a national securities exchange prior to January 1, 1970, for the purpose of providing assistance to customers of members of such exchange, shall not result in any taxable gain to such trust or give rise to any taxable income to any member of SIPC under any provision of the Internal Revenue Code of 1954 [26 USCS §§ 1 et seq.], nor shall such contribution or transfer, or any reduction in assessments made pursuant to this Act, in any way affect the status, as ordinary and necessary expenses under section 162(a) of the Internal Revenue Code of 1954 [26 USCS § 162(a)], of any contributions made to such trust by such exchange at any time prior to such transfer. Upon dissolution of SIPC, none of its net assets shall inure to the benefit of any of its members.

(f) 15 USCS § 78t(a) not to apply. The provisions of subsection (a) of section 20 of the 1934 Act [15 USCS

§ 78t(a)] shall not apply to any liability under or in connection with this Act.

(g) SEC study of unsafe or unsound practices. Not later than twelve months after the date of enactment of this Act [enacted Dec. 30, 1970], the Commission shall compile a list of unsafe or unsound practices by members of SIPC in conducting their business and report to the Congress (1) the steps being taken under the authority of existing law to eliminate those practices and (2) recommendations concerning additional legislation which may be needed to eliminate those unsafe or unsound practices.

(Dec. 30, 1970, P. L. 91-598, § 15[11], 84 Stat. 1655; May 21, 1978, P. L. 95-283, §§ 9, 14, 92 Stat. 260, 270.]

§ 78lll. Definitions

For purposes of this Act, including the application of the Bankruptcy Act [11 USCS §§ 101 et seq.] to the liquidation proceeding:

(1) Commission. The term "Commission" means the Securities and Exchange Commission.

(2) Customer. The term "customer" of a debtor means any person (including any person with whom the debtor deals as principal or agent) who has a claim on account of securities received, acquired, or held by the debtor in the ordinary course of its business as a broker or dealer from or for the securities accounts of such person for safekeeping, with a view to sale, to cover consummated sales, pursuant to purchases, as collateral security, or for purposes of effecting transfer. The term "customer" includes any person who has a claim against the debtor arising out of sales or conversions of such securities, and any person who has deposited cash with the debtor for

the purpose of purchasing securities, but does not include —

(A) any person to the extent that the claim of such person arises out of transactions with a foreign subsidiary of a member of SIPC; or

(B) any person to the extent that such person has a claim for cash or securities which by contract, agreement, or understanding, or by operation of law, is part of the capital of the debtor, or is subordinated to the claims of any or all creditors of the debtor, notwithstanding that some ground exists for declaring such contract, agreement, or understanding void or voidable in a suit between the claimant and the debtor.

(3) Customer name securities. The term "customer name securities" means securities which were held for the account of a customer on the filing date by or on behalf of the debtor and which on the filing date were registered in the name of the customer, or were in the process of being so registered pursuant to instructions from the debtor, but does not include securities registered in the name of the customer which, by endorsement or otherwise, were in negotiable form.

(4) Customer property. The term "customer property" means cash and securities (except customer name securities delivered to the customer) at any time received, acquired, or held by or for the account of a debtor from or for the securities accounts of a customer, and the proceeds of any such property transferred by the debtor, including property unlawfully converted. The term "customer property" includes —

(A) securities held as property of the debtor to the extent that the inability of the debtor to meet its obligations to customers for thier net equity claims based on securities of the same class and series of an issuer is attributable to the debtor's noncompliance with the requirements of section 15(c)(3) of the 1934 Act [15 USCS § 78*o*(c)(3)] and the rules prescribed under such section;

(B) resources provided through the use or realization of customers' debit cash balances and other customer-related debit items as defined by the Commission by rule;

(C) any cash or securities apportioned to customer property pursuant to section 6(d) [15 USCS § 78fff(d)]; and

(D) any other property of the debtor which, upon compliance with applicable laws, rules, and regulations, would have been set aside or held for the benefit of customers, unless the trustee determines that including such property within the meaning of such term would not significantly increase customer proerty.

(5) Debtor. The term "debtor" means a member of SIPC with respect to whom an application for a protective decree has been filed under section 5(a)(3) [15 USCS § 78eee(a)(3)] or a direct payment procedure has been instituted under section 10(b) [15 USCS § 78fff-4(b)].

(6) Examining authority. The term "examining authority" means, with respect to any member of SIPC (A) the self-regulatory organization which inspects or examines such member of SIPC, or (B) the Commission if such member of SIPC is not a

member of or participant in any self-regulatory organization of if the Commission has designated itself examining authority for such member pursuant to section 13(c) [15 USCS § 78iii(c)].

(7) Filing date. The term "filing date" means the date on which an application for a protective decree is filed under section 5(a)(3) [15 USCS § 78eee(a)(3)], except that —

(A) if a petition under Title 11 of the United States Code [11 USCS §§ 101 et seq.] concerning the debtor was filed before such date, the term "filing date" means the date on which such petition was filed;

(B) if the debtor is the subject of a proceeding pending in any court or before any agency of the United States or any State in which a receiver, trustee, or liquidator for such debtor has been appointed and such proceeding was commenced before the date on which such application was filed, the term "filing date" means the date on which such proceeding was commenced; or

(C) if the debtor is the subject of a direct payment procedure or was the subject of a direct payment procedure discontinued by SIPC pursuant to section 10(f) [15 USCS § 78fff-4(f)], the term "filing date" means the date on which notice of such direct payment procedure was published under section 10(b) [15 USCS § 78fff-4(b)].

(8) Foreign subsidiary. The term "foreign subsidiary" means any subsidiary of a member of SIPC which has its principal place of business in a foreign country or which is organized under the laws of a foreign country.

(9) Gross revenues from the securities business. The term "gross revenues from the securities business" means the sum of (but without duplication) —

(A) commissions earned in connection with transactions in securities effected for customers as agent (net of commissions paid to other brokers and dealers in connection with such transactions) and mark-ups with respect to purchases or sales of securities as principal;

(B) charges for executing or clearing transactions in securities for other brokers and dealers;

(C) the net realized gain, if any, from principal transactions in securities in trading accounts;

(D) the net profit, if any, from the management of or participation in the underwriting or distribution of securities;

(E) interest earned on customers' securities accounts;

(F) fees for investment advisory services (except when rendered to one or more registered investment companies or insurance company separate accounts) or account supervision with respect to securities;

(G) fees for the solicitation of proxies with respect to, or tenders or exchanges of, securities;

(H) income from service charges or other surcharges with respect to securities;

(I) except as otherwise provided by rule of the Commission, dividends and interest received on

securities in investment accounts of the broker or dealer;

(J) fees in connection with put, call, and other option transactions in securities;

(K) commissions earned from transactions in (i) certificates of deposit, and (ii) Treasury bills, bankers acceptances, or commercial paper which have a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof, the maturity of which is likewise limited, except that SIPC shall by bylaw include in the aggregate of gross revenues only an appropriate percentage of such commissions based on SIPC's loss experience with respect to such instruments over at least the preceding five years; and

(L) fees and other income from such other categories of the securities business as SIPC shall provide by bylaw.

Such term does not include revenues received by a broker or dealer in connection with the distribution of shares of a registered open end investment company or unit investment trust or revenues derived by a broker or dealer from the sale of variable annuities or from the conduct of the business of insurance.

(10) Liquidation proceeding. The term "liquidation proceeding" means any proceeding for the liquidation of a debtor under this Act in which a trustee has been appointed under section 5(b)(3) [15 USCS § 78eee(b)(3)].

(11) Net equity. The term "net equity" means the dollar amount of the account or accounts of a customer, to be determined by —

(A) calculating the sum which would have been owed by the debtor to such customer if the debtor had liquidated, by sale or purchase on the filing date, all securities positions of such customer (other than customer name securities reclaimed by such customer); minus

(B) any indebtedness of such customer to the debtor on the filing date; plus

(C) any payment by such customer of such indebtedness to the debtor which is made with the approval of the trustee and within such period as the trustee may determine (but in no event more than sixty days after the publication of notice under section 8(a) [15 USCS § 78fff-2(a)]).

In determining net equity under this paragraph, accounts held by a customer in separate capacities shall be deemed to be accounts of separate customers.

(12) Persons registered as brokers or dealers. The term "persons registered as brokers or dealers" includes any person who is a member of a national securities exchange.

(13) Protective decree. The term "protective decree" means a decree, issued by a court upon application of SIPC under section 5(a)(3) [15 USCS § 78eee(a)(3)], that the customers of a member of SIPC are in need of the protection provided under this Act.

(14) Security. The term "security" means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, any collateral trust certificate, preorganization certificate or subscription, transferable share, voting trust certificate, certificate of deposit,

certificate of deposit for a security, any investment contract or certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or mineral royalty or lease (if such investment contract or interest is the subject of a registration statement with the Commission pursuant to the provisions of the Securities Act of 1933), any put, call, straddle, option, or privilege on any security, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase or sell any of the foregoing, and any other instrument commonly known as a security. Except as specifically provided above, the term "security" does not include any currency, or any commodity or related contract or futures contract, or any warrant or right to subscribe to or purchase or sell any of the foregoing.

(Dec. 30, 1970, P. L. 91-598, § 16[12], 84 Stat. 1656; May 21, 1978, P. L. 95-283, §§ 9, 15, 92 Stat. 260, 271; Nov. 6, 1978, P. L. 95-598, Title III, § 308(o), 92 Stat. 2676; Oct. 13, 1982, P. L. 97-303; § 7, 96 Stat. 1410.)